STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 92-345(II)

January 10, 1995

CENTRAL MAINE POWER COMPANY
Re: Proposed Increase in Rates

DETAILED OPINION AND
SUBSIDIARY FINDINGS

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I. SUMMARY OF DECISION[1]

This Order adopts the October 14, 1994 stipulated Alternative Rate Plan [2] ("ARP" or "stipulated ARP") for CMP signed by nearly all of the active parties in Phase II of this case. The October 14th Stipulation ("the Stipulation") [3] sets forth the way in which Central Maine Power Company's ("CMP" or the "Company") rates will be determined for the next 5 years.

In our view, the adoption of the Stipulation represents a very positive step for regulation in Maine. The Stipulation provides, under a very broad set of assumptions, a high degree of stability and predictability in electric rates for CMP customers. In light of the substantial and often unpredictable rate increases of recent years, these benefits are worth achieving.

As a Commission, we have an obligation to mirror the effects of genuine competition to the extent consistent with our broader

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[1]Pursuant to Section 1003(b) of Chapter 110 of the Commission's Rules of Practice and Procedure, the Commission has issued a two-part decision in this proceeding. A Summary amd Decision and Order ("Short Order") was issued on December 30, 1994. This document ("Long Order") contains our detailed opinion and subsidiary findings.

[2]The Phase I Order uses the term "Rate Stability Plan" in describing the policy goals that we thought that an ARP could serve. In this Order, we find that the stipulated ARP complies with the policy goals of a Rate Stability Plan as identified in the Phase I Order. However, we have not used the term "Rate Stability Plan" in this Order because of the potential confusion of that term with a "Rate Stabilization Agreement" as that term is used in 35-A M.R.S.A. § 3156 and because the stipulated ARP provides a variety of benefits in addition to rate stability, including ongoing regulation and oversight, rate predictability, risk shifting and improved incentives for CMP.

[3]The October 14th Stipulation was signed by CMP, the Advocacy Staff, the Office of the Public Advocate, the Commercial Customer Utility Coalition, the Department of the Navy and the American Association of Retired Persons ("stipulating parties"). The Alliance to Benefit Consumers (ABC) filed a Brief in which it opposed the Stipulation. The Industrial Energy Consumer Group and the Bath Iron Works Corporation did not file briefs and took no formal position with regard to the Stipulation.

commitment to serve the public interest. The proposed Stipulation fulfills this obligation in at least two ways. First, the pricing flexibility component moves toward leveling the playing field between CMP and its competitors in the retail energy market, while recognizing that the degree of competition, and consumer information and expectations, have not yet reached the point where all pricing constraints can safely be removed. Second, the price cap provisions of the Stipulation, together with the virtual elimination of the fuel clause, give incentives and create risks for CMP's management much closer to those found in less regulated companies. We view this as a positive step away from the imperfect surrogate to market pressures provided by more traditional regulation, to a more direct link between performance and profits.

No one should interpret our adoption of the Stipulation as a willingness to abandon our central regulatory task of ensuring that CMP's customers receive adequate service at just and reasonable rates. Indeed, the Stipulation explicitly preserves the full panoply of traditional regulatory tools that would permit our intervention if it appears that the new form of regulation is operating against this central objective, and in fact creates new tools to help ensure that service quality and demand-side management objectives are met.

Finally, there is another important factor weighing in favor of our permitting the Stipulation to take effect. There are many occasions where government in general, and the Commission in particular, must choose between or among irreconcilable positions. At one level, that is the Commission's job description: to determine which party's proposals best effectuate the Legislature's objectives.

There are also occasions, however, and we believe this is one, where the Commission should defer to the efforts of the parties before it; who have reached an overall resolution to a complex and difficult set of problems. We must, of course, decide whether the proposed resolution is contrary to legislative mandate (and here we conclude that the Stipulation is fully consistent with all applicable laws); and we should also assess whether the parties proposing the Stipulation represent a sufficiently broad spectrum of interests so we can be sure there is no appearance or reality of disenfranchisement. In fact, this Stipulation is supported by an extraordinarily broad range of interests: the Public Advocate, charged with representing consumer interests; the Commission's Advocacy Staff, responsible to the Commission to present its best estimation of the appropriate balance of interests among the parties; the CCUC, a group representing commercial customers; the AARP, which has elsewhere opposed alternative rate plans, and which champions residential customers; the department of the Navy; and CMP, representing the interests of its shareholders.

We are personally gratified that such diverse interests have found common ground for resolving the difficult and immensely important question of how we should tailor our regulatory process to the changing needs of CMP and its customers. Government should not always assume that we are the keepers of perfect wisdom, and that deviations from exactly what we think is the "right" answer should be prohibited. Government can and should also serve as a forum for parties to work out their differences in the spirit of common purpose and mutual benefit. We will not, of course, abandon our independent judgment. We remain the arbiters of disputes, and we must ensure that the Legislature's policies are carried out. But cooperative efforts as an alternative to contentious litigation should be encouraged, and for that reason -- among many others -- we have concluded that the Stipulation should be approved without modification.

II. INTRODUCTION AND BACKGROUND

A. Procedural History

The procedural history of Phase II of this proceeding is set forth in Appendix A of this Order.

B. Historical Context: Overview of the Events Leading up to the Stipulation

With this Order, we hope to end a tumultuous period in CMP's history in a way that will likely provide significant benefits to CMP's ratepayers, and provide CMP with increased incentives to be efficient.

In the last few years, the level and the rate of increase of CMP's rates and CMP's inability to moderate those rate increases have led to very contentious rate cases before the Commission. On a Company-wide basis, CMP's rates rose about 10% per year from 1990 through 1992. Such rapid rate increases led to widespread public concern that the level and design of CMP's rates were serious problems for all classes of CMP's customers and that further rate increases must be moderated.

In the August 5 Order in Docket Nos. 92-078 and 89-068, the Commission:

- Ordered a focused management audit for CMP and an informal investigation of CMP's financial condition. The Commission specified that the focused management audit should investigate CMP's management structure, staffing levels, executive compensation and salaries, cost cutting and management efficiency. The purpose of the focused management audit was to "ensure that CMP is run efficiently;"

- Noted that CMP's next base rate case would be pursued with "aggressive scrutiny, seeking cost reduction in every possible area of the Company's revenue requirement;" and,

- Stated that expanded participation by representatives of customer classes that do not usually have an independent voice in Commission proceedings would provide additional perspectives for Commission consideration and would likely improve the substance of Commission proceedings.

On March 1, 1993, CMP filed a base rate case that requested a $95 million increase in nonfuel rates. CMP's request, which was litigated in Phase I of this proceeding, heightened the public's concerns about CMP's rates. On December 14, 1993, we granted a $26.2 million rate increase for CMP. In the Phase I Order, we acknowledged that CMP's rates had risen significantly in recent years, which adversely affected CMP's competitive position during a severe recession. The Commission specifically found that:

- CMP had engaged in a reactive strategy of "responsibility deflection" rather than "proactively cutting costs," indicating that CMP lacked a corporate culture that was strongly committed to cost cutting;

- CMP's "performance in the area of management efficiency and cost cutting has been inadequate." Based on the information provided by the management audit and other evidence, the Commission imposed a $25.3 million management efficiency adjustment; and,

- An ARP is likely to provide a "better means" to ensure that ratepayers do not pay for inefficiency and that

> management has the proper incentive to control costs.

Regarding ARP issues, the Phase I Order found that:

> The record in this proceeding supports prompt consideration of an alternative ratemaking plan for CMP. Since the record identifies "implementation" and other issues that should be further explored, the Commission directs CMP, Advocate Staff and any other party who wants to participate, to develop a specific price-cap plan for CMP.

C. The Implementation Issues

In our Phase I Order, we stated that:

> [W]e find that an alternative rate plan, in particular a price cap mechanism, is likely to be a better means to ensure that ratepayers do not pay for inefficiency and that management has the proper incentive to control costs. We also believe that this alternative way better accommodates the growing level of competition in the electric industry by providing greater flexibility to CMP without sacrificing the interests of CMP's "core" ratepayers.

We found that the precise parameters of the proper ARP for CMP required additional development in a second phase of this proceeding, and identified the following 11 "implementation issues" that required additional development by the parties in the Phase II proceeding:

1. Selection of a price index

2. Creation of a profit-sharing component

3. Productivity offset

4. Scope of annual review

5. Customer satisfaction and reliability incentives

6. Definition of mandated costs

7. Treatment of fuel and purchased-power costs

8. Effect on demand-side management (DSM) activities

9. Termination option

10. Pricing flexibility

11. Electricity Lifeline Program ("ELP") under an ARP

The Phase I Order emphasized items 3, 5 and 7, above, as the most important issues. The Order also posed questions and identified concerns relating to all 11 issues.

D. Framework of this Order

In Part III of this Order, we undertake a summary and analysis of each of the discrete components of the Stipulation. In Part IV we discuss the goals of an alternative rate plan and analyze whether the stipulated ARP achieves these goals. Part IV includes separate financial and qualitative analyses of the Stipulation as well as a discussion of the Commission's legal authority to adopt an ARP for CMP. In Part V of this Order, we discuss proposed schedule revisions and 5-year contracts that CMP filed on November 22, 1994 pursuant to the pricing flexibility provisions of the Stipulated ARP.

The October 14th Stipulation is attached to and incorporated into the Order. Our description of the provisions of the Stipulation in the text of this Order is summary in nature and omits specific details about the Stipulation. For the purposes of this Order and future proceedings, the Stipulation is the controlling document regarding the specific terms and requirements of the ARP that we have adopted for CMP.

III. SUMMARY AND ANALYSIS OF THE COMPONENTS OF THE STIPULATION

A. Introductory Remarks

While the question before us is whether or not to approve the Stipulation, an extensive record has been developed on alternative rate plans in both phases of this proceeding. The Phase I record in this case includes extensive evidence, both pro and con, on the advisability of moving to a new form of rate regulation, such as price cap regulation.

The record in Phase II of this proceeding includes ample evidence regarding the advisability of adopting a new form of rate regulation and two alternative designs of an ARP for CMP. The two plans presented in Phase II were an ARP developed by CMP and an ARP, known as the Public Party/Customer Proposal (PPCP), developed by most of the non-CMP parties in this proceeding, including the Advocacy Staff (Staff), the Commercial Customers Utility Coalition (CCUC), the Office of the Public Advocate (OPA), the Maine State Legislative Committee of the American Association of Retired Persons (AARP) and the Department of the Navy (Navy).[4] Appendix B to this Order summarizes the major provisions of the PPCP ARP, the CMP ARP and the stipulated ARP.

What follows is a summary and analysis of the components of the stipulated ARP.

B. Price Cap Component

In Phase I of this case, the Commission found that an ARP should be composed of a price cap with profit-sharing, and pricing flexibility. The stipulated ARP contains these components.

The price cap in the stipulated ARP is a price ceiling and is adjusted annually. The price cap formula includes a price index, a productivity offset, a profit sharing mechanism, sharing of QF restructuring benefits, flowthrough items and a mechanism to recognize mandated costs.

1. Starting Point

The stipulated ARP incorporates a starting point that is set at current rates (based upon the Phase I rate case decision in this proceeding as adjusted by the August 1, 1994 fuel adjustment clause increase and the FEV QF buyout).[5]

2. Price Index

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[4]During the discovery and hearing phase of this case, the OPA and AARP recommended that no ARP be adopted for CMP at this time. However, both parties preferred the PPCP ARP to the CMP ARP.

[5]See Central Maine Power Co, Application for Fuel Cost Adjustment, Docket No. 94-103 (July 21, 1994) and Central Maine Power Co., Proposed Electric Rate Stabilization Project, Docket No. 94-213 (Aug. 18, 1994).

The stipulated ARP uses the Gross Domestic Product-Price Index ("GDP-PI") as the inflation (price) index. The price index is the percentage of increase in the GDP-PI price index for the fourth quarter of the prior year compared to the GDP-PI for the fourth quarter of the preceding year. This index is reported by the U.S. Department of Commerce, Bureau of Economic Analysis pursuant to Paragraph 6 and Attachment I of the Stipulation. [6] The GDP-PI is an economy-wide index, similar to the indexes listed in the Phase I Order.

We agree that the GDP-PI as applied in Attachment I is a reasonable measure of inflation for purposes of establishing a price index. This measure is a much broader index than the CPI-U index, is based on a more current market basket than the CPI-U (1987 versus 1982-1984), and has exhibited more stability than the CPI-U over the years.

3. Productivity Offset and QF Factor

The ARP reflects a general productivity offset of 1.0% and a QF factor of 0.375, based on the assumption that 37.5% of CMP's total costs are not affected by inflation. For 1995, the productivity offset is 0.5%. For 1996, the offset is 1.0% if inflation is below 4.5% and the greater of 3.5% or (1-.375)x(inflation - 1.0%) for inflation above 4.5%. For the 1997-1999 period, if inflation is 3%, the productivity offset and QF factor will be 1.75% per year. As inflation rises, so does the size of the productivity offset.

In our Phase I Order, we noted that the productivity offset is "the most significant issue in determining the specific characteristics" of an ARP, and indicated that the productivity offset should be no less than one percent. We also suggested that a "stretch factor" to the productivity offset be considered to minimize risks to consumers and to provide further incentive for CMP to improve its cost efficiency.

The level of the productivity offset is important because it affects the allocation of efficiency gains between CMP shareholders and ratepayers. The stipulated ARP's offset is reasonable because it provides ratepayers with a significant share of potential efficiency gains and allows CMP an opportunity

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[6] Citations in this Order to "Paragraph" or "Attachment" refer to the numbered provisions and lettered attachments of the Stipulation.

to gradually improve its financial integrity. We also find that the QF factor provides an appropriate way to address the fact that a substantial portion of CMP's fuel costs are not directly affected by inflation.

4. Profit-Sharing

The price cap has a profit-sharing component that adjusts the subsequent year's earnings if the earnings are outside a ±350-basis-point bandwidth around the authorized cost of equity (currently 7.05% to 14.05%). CMP's current authorized cost of equity is 10.55%. The profit-sharing component will be in effect for each price change taking place on or after July 1, 1996. Paragraph 7.

In our Phase I Order, we envisioned an ARP that would include, among other things, a profit-sharing component. We set forth certain issues regarding the design of a profit-sharing mechanism, such as the specification of the profit-sharing bands and the sharing ratios.

a. Profit Bandwidth

The Stipulation incorporates a ±350-basis-point bandwidth above and below a benchmark return on equity of 10.55%, as adjusted by the ROE benchmark discussed below. The earned ROE is calculated by first computing the earned ROE on a "financial reporting basis." That figure is adjusted as required by law or regulation to exclude revenues, expenses or profits (or losses) that must be removed for ratemaking purposes. Paragraphs 7(a) and 7(b).

We find that a wide bandwidth provides: 1) a "safety net" that protects the Company and ratepayers from the increased risks associated with extreme swings in earnings; 2) further benefits to ratepayers if CMP is able to achieve significantly improved profitability; 3) a way to shift the risks of low profitability away from ratepayers; and 4) improved incentives and risk allocation. Therefore, we find the ±350-basis-point bandwidth contained in the Stipulation to be reasonable.

b. Sharing Ratios

The Stipulation provides for a 50/50 sharing of profits or losses outside the ±350-basis-point bandwidth. Earnings will be computed on a calendar year basis and the sharing, if any, will be effective on July 1 of the year immediately following the applicable calendar year. Paragraph 7(c).

We concur with the stipulating parties that the 50/50 sharing ratio strikes a reasonable balance between the need to provide a strong efficiency incentive to CMP and the concern that the risk allocation between ratepayers and shareholders must be manageable from a financial perspective.

c. ROE Benchmark

The Stipulation indexes the ROE benchmark for purposes of the profit-sharing mechanism. The index, on a 12-month calendar year basis, averages the dividend yields of Moody's group of 24 electric utilities and Moody's utility bond yields. The index value is compared to the base year average (computed for the period July 1, 1992 through June 30, 1993), and the difference is added to, or subtracted from, the current 10.55% authorized ROE. The Stipulation also limits CMP's common equity ratio for purposes of this calculation to no more than 50%. Paragraph 7(d); Attachment B.

The Commission last established CMP's capital structure and return on equity in the Phase I Order. The Stipulation adopts our Phase I cost of equity of 10.55%, although the cost of capital and capital structure issues will be reconsidered during the mid-period review in 1997. Paragraph 21. Under the profit-sharing component, the maximum allowed common equity ratio is limited to 50%. This feature of the Stipulation ameliorates our concern that if CMP's common equity ratio rises above 50% that an "earnings sharing" rate increase would be more likely to occur.

We have two minor concerns about the ROE benchmark. First, we are concerned that given recent significant increases in interest rates, the ROE benchmark could reduce or eliminate any potential "upside" benefit to ratepayers under the profit-sharing component. Second, in terms of methodology, we believe that the Moody's "dividend yield" and "utility bond yield" benchmarks can provide only a rough approximation of changes in CMP's cost of equity. The Moody's dividend yield, for example, does not reflect changes in the expected dividend growth rate of the index.

While this ROE benchmark feature of the profit-sharing component has the minor drawbacks noted above, these drawbacks are not significant enough to cause us to reject the Stipulation. The ROE benchmark is relatively easy to calculate and will help to ensure that the earned ROE is set within a reasonable range.

5. Passthrough Items

a. Mandated Costs

The Stipulation lists certain mandated costs that must be dealt with outside the price index and provides a definition that limits potential future mandated costs. Specifically identified mandated costs include:

- Demand-Side Management (DSM) costs that will be included in the price change beginning in 1996. Deferred DSM costs and reconcilable costs will be treated as mandated costs with an annual price increase limitation of $2 million. Any excess over this $2 million limitation will be deferred and recovered as part of the next price change. Paragraph 11(a).

- Fifty percent of the costs of transition to Statement of Financial Accounting Standards (SFAS) No. 106 (Employers' Accounting for Post-Retirement Benefits Other Than Pensions) will be recovered as a passthrough item. This amount will be phased in ratably over 3 years beginning in 1995. Paragraph 11(b).

- Electric Lifeline Program benefits will be funded based upon current Commission requirements. Any difference between actual and funded levels will be deferred until the mid-period review. Paragraph 13.

During the annual review proceedings under the stipulated ARP, the Commission will review any future mandated costs that are not specifically identifiable at this time and meet the following three criteria:

- Exceed $3 million in annual revenue requirements at the time of inclusion in rates for each item;

- At least have a disproportionate effect on the Company or the electric utility industry; and

- Not be adequately accounted for in the price index. Paragraph 12.

Any cost increases or decreases that satisfy these three criteria will be reviewed during the corresponding ARP review and any non-recurring costs will be removed from rates in the year following full recovery.

In our Phase I Order, we stated that the list of mandated costs should be kept to a minimum to encourage CMP to control costs. We believe that the Stipulation's definition of mandated costs is sufficiently limited. The qualifications imposed for their inclusion in the annual review are narrow enough to assure us that only significant and unusual cost changes will be passed through to customers.

b. QF Buyout Savings and Costs

Paragraphs 8 through 10 and Attachments C and D of the Stipulation describe the treatment of savings/costs associated with QF contract buyouts and restructurings that will no longer be processed through the fuel clause.

According to Paragraph 8, net savings from QF contract buyouts and restructurings consummated after October 1, 1994, will be shared 50/50 between shareholders and ratepayers (with several exceptions noted in Paragraphs 9 and 10). The ratepayer share of net savings/costs during a calendar year will be flowed through to ratepayers during the next year. At the time of the annual review, CMP will file its estimate of net savings/costs during the previous year and other parties will be able to examine these estimates. Attachment C further defines net savings/costs and the treatment of up-front costs associated with restructuring.

Paragraph 9 describes the flowthrough of savings from the recent buyout of Fairfield Energy Venture (FEV). Under this provision, there will be a $1.4 million rate decrease on July 1, 1995, which is in addition to the $5.6 million decrease that was implemented on December 1, 1994. In the event that there are additional costs or savings associated with the FEV buyout, these will be flowed through in the manner described in Attachment D of the Stipulation.

Paragraph 10 and Attachment D describe the flowthrough of net savings/costs from QF contract buyouts and restructurings that are financed through the Finance Authority of Maine (FAME). All of these net savings/costs will be flowed through to ratepayers on an annual basis as a mandated cost. During the annual review proceedings, CMP will file an estimate of its savings/costs for the upcoming rate year, report partially estimated actual savings/costs for the current rate year, and flow through any difference to ratepayers at the time of the next scheduled rate change.

The Commission's Phase I Order discusses a number of concerns related to the recovery of purchased power costs in the fuel clause, the removal of capacity costs from the fuel clause, and the incentive effects of various treatments. Pursuant to Paragraph 22 of the Stipulation, the fuel clause for CMP is terminated during the term of the stipulated ARP, which eliminates our concerns regarding the treatment of purchased power costs in the fuel clause.

We find that the 50/50 sharing between ratepayers and shareholders of savings due to QF contract buyouts and restructurings creates strong incentives for CMP to seek such savings and is reasonable. The treatment of savings from the FEV restructuring, financed through FAME, is consistent with 35-A M.R.S.A. § 3156. The Stipulation's differing treatment of savings for FAME-financed buyouts and restructurings (100% passthrough to ratepayers) and savings from other QF buyouts and restructurings (50/50 sharing) may have the unintended effect, however, of giving CMP an incentive to seek alternatives to FAME financing. We intend to monitor how future buyouts and restructurings are financed to prevent this unintended incentive from working to the detriment of CMP's customers. We note that the 100% passthrough provision applies only when FAME financing is involved. Only $33.5 million of funds remain available for QF buyouts or buydowns that are executed before May 1, 1995.

6. The Price Index Formula

In this part of the Order, we summarize and analyze how the price cap components (the price index, the productivity offset, and the QF factor) will work in tandem under the stipulated ARP. Passthrough items are not included in the discussion in this section. Thus, actual price increases are likely to be different from those presented in this section. For estimates of projected rate increases under the ARP, including currently known passthrough items, see Part IV (B).

The price index, the productivity offset (0.5% in 1995 and one percent in 1996-99) and the QF factor (37.5% in 1996-99), can be summarized in the following equations:

1995: Price index = Inflation% - 0.5%

1996: If inflation is $\leq$ 4.5%, then the:

Price index = Inflation% - 1.0%

If inflation is > 4.5%, then the
Price index = the greater of:

a) 3.5%; or,

b) (1 - 0.375) * (Inflation - 1.0%)

1997-99: Price index = (1 - 0.375) * (Inflation - 1.0%).

Table 1 below presents the results of the above equations given various inflation assumptions. In all years, the assumed price increase is less than the rate of inflation. It is possible that actual inflation rates will be higher or lower than the range of rates summarized in Tables 1 and 2.

TABLE 1

ASSUMED PRICE INCREASES FOR ELECTRICITY GIVEN VARIOUS ASSUMED INFLATION RATES (EXCLUDES PASSTHROUGH ITEMS)

GDP-PI Change	1995	1996	1997-1999
3.0%	2.5%	2.0%	1.2500%
3.5%	3.0%	2.5%	1.5625%
4.0%	3.5%	3.0%	1.8750%
4.5%	4.0%	3.5%	2.1875%
5.0%	4.5%	3.5%	2.5000%
5.5%	5.0%	3.5%	2.8125%
6.0%	5.5%	3.5%	3.1250%

Based on these considerations, we find that the price cap component of the Stipulation is reasonable.

7. Summary of Price Cap Analysis

The price cap component of the Stipulation provides a balanced and workable price cap ratemaking formula. We find a number of benefits in the price cap component of the Stipulation.

- The formula provides for rate increases that are below the prior year's inflation rate in all cases.

- The 0.5% productivity offset in 1995 provides the Company with a reasonable opportunity gradually to improve its financial integrity, which should benefit both ratepayers and shareholders in the long term.

- The overall offset to the price index, including the productivity offset and the QF factor, is significantly greater than one percent.

- Dollar-for-dollar recovery of fuel and purchased power costs under the reconcilable fuel adjustment clause is eliminated, which should provide improved cost cutting incentives to CMP.

- The productivity offset provides ratepayers with a significant share of potential efficiency gains.

- The profit bandwidth is wide enough to assure us that only extreme swings in earnings will be shared by ratepayers and shareholders.

- The 50/50 sharing ratio between shareholders and ratepayers is clear and understandable and will provide improved incentives relative to traditional regulation.

- The benchmark ROE will be sufficiently straightforward to calculate during the annual review.

Based on these findings, we conclude that the price-cap component of the Stipulation is reasonable and will produce rates that are just and reasonable.

C. Pricing Flexibility Component

1. Summary of the Stipulation

Paragraph 15 and Attachment F of the Stipulation establish the pricing flexibility component of the ARP. Attachment F describes the pricing flexibility program and serves as its terms and conditions. Paragraph 15 also acknowledges that the issue of interim floor prices will have to be resolved before the program can be fully implemented.

Described broadly, the stipulated ARP's pricing flexibility program provides a number of options within which CMP may price flexibly, typically between a marginal-cost-based floor and a rate cap (at the rate levels established by the ARP pricing mechanism), without having to seek Commission approval. It includes a number of safeguards designed to protect core customers, to avoid undue discrimination, and to preserve Commission policy as expressed in the Docket No. 92-315 Phase I Order.[7] Proposals not meeting the criteria of this program are

[7] Central Maine Power Co., Commission Investigation of Company's Resource Plan, Docket No., 92-315(I) (Feb. 18, 1994).

permissible, but require Commission review, which will be completed within a maximum of four months. Rate design proceedings, that lower rates for some customers while raising rates for others, may occur during the ARP.

What follows is a summary of the pricing flexibility provisions set forth in Attachment F. These summaries, however, omit important details that are in Attachment F, which remains the controlling document.

a. Existing Customer Classes

For existing customer classes, CMP may set rates between the rate cap and long-term marginal cost (except that the discount from the rate cap cannot exceed 40%). Changes can occur no more than twice a year (in addition to the annual rate cap change). Individual rate elements for an existing customer class can be modified, subject to a number of rules and limitations. The existence or absence of a block structure will be maintained, although limited modifications to the relationship among blocks are permissible, subject to similar rules. Larger changes in rate design may be considered in Phase II of Docket No. 92-315. Long-term marginal costs will be established in that same proceeding, and will be updated in limited ways during the ARP annual reviews.

The Company must file proposed rate change schedules with an effective date of 30 days. Parties may comment or object. The Commission will suspend the proposed schedules only if it finds that the schedules do not conform to ARP requirements. Decisions on suspended schedules must be made within 4 months of the Company's initial filing. This procedure allows conforming rates to go into effect in 30 days without the need for Commission approval. The Company must provide regular notice to customers that are charged rates below the rate cap, warning them of certain risks.

b. New Customer Classes for Optional Targeted Service

CMP may establish new customer classes for targeted services, based on marketing characteristics. Rates for newly created customer classes will be capped at the rate of the class that the customer would have otherwise been in. Filing and notice procedures are the same as those for proposed changes to existing customer classes. Temporary and permanent load are treated differently.

Temporary targeted rates are for short-term load retention and incremental sales. Rates will be set such that the total revenue collected will at least equal short-run marginal cost plus 1.5¢/kWh. Rate elements will at least equal short-run marginal cost.

Permanent load is defined as load that is expected to continue indefinitely, regardless of rate changes. Rates will be set such that the total revenue collected will at least equal long-term marginal cost. Rate elements will at least equal long-term marginal cost. CMP may not use these rates to promote residential baseboard resistance heating. Rates that satisfy these criteria may become effective in 30 days, provided that CMP shows that the cost tests described in section d., below, are likely to be satisfied.

c. Special Rate Contracts with Individual Customers

CMP may enter into special rate contracts with individual customers. Long-term and short-term contracts are treated differently.

"Short-term" contracts are defined as contracts for 5 years or less entered into during 1995 and 1996, and for 3 years or less thereafter. For short-term contracts serving temporary load, rates will be such that the total revenue collected will at least equal short-run marginal cost plus 1.5¢/kWh. Rate elements will at least equal short-run marginal cost. Notice and filing requirements are similar to those discussed in part a., above.

Long-term contracts require Commission review and approval. Direct competitors will be identified and notified of the pending special rate contract.

For contracts inducing load that is expected to be permanent, rates charged will be designed to ensure that the total revenue and individual rate elements will at least equal long-term marginal cost. CMP will take all reasonable steps to guarantee that any permanent load that is acquired is consistent with State energy policy and regulation, and that the customer is made aware of all of CMP's energy efficiency programs. Special rate contracts for permanent load meeting these criteria may go into effect in 30 days without Commission approval, provided that CMP shows that certain cost tests described in part d., below, are likely to be satisfied.

d. Cost Tests for Permanent Load

The cost tests for targeted service rates and special contracts, where the load is expected to be permanent, are the revenue test, total resource test, and participant test. The revenue test concerns the effect of a load on the utility's net revenues (present value) over the duration of the load, thus focusing on the utility's economic interests. The total resource test is an analysis of the overall economic efficiency of the energy end use which considers costs and benefits to the utility, ratepayers, and participants taken together. The participant test looks at costs and benefits from the participant's perspective. This last test need not be satisfied for loads in excess of 20 kW.

e. Mitigation of Risks Associated with Pricing Flexibility

Ratepayers could be adversely affected by pricing flexibility if the resulting revenue losses trigger the earnings sharing mechanism of the ARP. To limit ratepayer exposure to this risk, a "Revenue Delta Cap" is established, equal to 15% of the revenue that would have been collected if all actual kWh sales had been charged at full capped rates. Attachment F at 9. CMP will estimate the Revenue Delta at the time of the annual review. CMP will be required to petition the Commission for authority to offer further discounted rates if the cap has been exceeded, or appears likely to be exceeded. [8]

During the mid-period review in 1997, the Commission will review the pricing flexibility provisions of the ARP. When the ARP ends, the Commission will consider reducing discounts before raising other rates. [9] CMP will track and report in the annual review the results of its load growth efforts. If

[8] The rate decrease for LGS-ST-TOU and LGS-T-TOU customers discussed in Part V below, amounts to about 15% of the revenue that would otherwise be collected. Because revenues from LGS-ST-TOU and LGS-T-TOU customers comprise about 30% of CMP's total revenues, it does not appear that the 15% Revenue Delta Cap will be exceeded as a result of CMP's proposed rate reduction for these two customer classes.

[9] This aspect of the Stipulation can be found in Attachment F(V)(C) (Transition out of ARP). Stipulation Paragraph 23 erroneously refers the reader to Attachment F(IV)(C).

CMP seeks additional generation resources, it must perform an analysis of costs, benefits, and rate impacts of such resource acquisition, including a showing that ratepayers are not harmed by the need to serve load that is induced by pricing flexibility.

2. Relevant Phase I Issues

In our Phase I Order, we made it clear that pricing flexibility was to be an important component of an ARP for CMP. In the Phase I Order, we noted that pricing flexibility would permit CMP to change rates between a maximum rate cap and a marginal-cost-based floor. We further noted that revenue deficits from reduced prices should be borne by shareholders, not ratepayers. We noted that this would be similar to competitive markets, in which similar deficits cannot be passed on to other customers, but must instead be addressed by seeking efficiency improvements. We also noted that pricing flexibility would enable CMP to compete to retain customers with alternative energy supply options. Pricing flexibility would incorporate a strong incentive to avoid free riders, because shareholders would bear all or most of the potential loss of poor management decisions. We further noted that pricing flexibility could enable the Commission to avoid having to process numerous special rate contracts on a case-by-case basis. Finally, the Commission raised a number of questions about pricing flexibility, including its scope, its relationship to rate design proceedings, and whether undue discrimination should be a serious concern.

3. Analysis of Pricing Flexibility Component

The stipulated ARP's pricing flexibility provisions address directly many concerns and recommendations articulated in our Phase I Order. With minor exceptions, the ARP's pricing flexibility provisions permit CMP to charge rates between the rate cap and the appropriate marginal cost-based floor. Captive customers are protected by the rate cap and revenue deficits are borne by shareholders, unless profit sharing is triggered. The wide $\pm$350-point-bandwidth and the Revenue Delta Cap mitigate this risk to ratepayers, although they do not eliminate it entirely. The stipulated ARP allows for a review of rates, should excessive downside sharing become a severe problem.

Because CMP will have substantial exposure to revenue losses due to discounting, the Company will have a strong incentive to avoid giving unnecessary discounts, and it will have a strong incentive to find cost savings to offset any such losses. Pricing flexibility gives CMP the opportunity to use price to compete to retain customers. These features of the ARP's pricing flexibility program simulate conditions in competitive markets and will help the Company adapt to increasing competition in its industry.

We agree that the Stipulation's requirement to provide notice to competitors addresses concerns about undue discrimination. We also agree that the cost tests in the Stipulated ARP provide a workable set of screening criteria for permanent load building programs.

The conditions imposed concerning rate elements and block relationships serve to preserve the most important rate design relationships that we have established in the past. At the same time, it will be possible to conduct rate design proceedings while the ARP is in place.

While we acknowledge that the Stipulated ARP's pricing flexibility program is complex, we appreciate the delicate balance required to reach a consensus solution. The ARP's recognition of the differences between temporary and permanent load through the incorporation of different types of marginal cost floors, is important, because the cost implications for CMP in the future may be quite different for these two types of load. We believe that it is desirable to give CMP as much flexibility within reasonably safe parameters as possible, while simultaneously protecting captive ratepayers.

Although complex, we find that the Stipulated ARP's pricing flexibility program is consistent with the concerns we expressed in our Phase I Order and achieves a reasonable balance among the conflicting goals of the stipulating parties.

D. Other Components

1. Low Income Programs

In the Phase I Order, we stated that CMP would be expected to continue to operate its Electric Lifeline Program efficiently and target benefits appropriately if an ARP is adopted. We do not expect that the Electric Lifeline Program will be affected by our approval of the stipulated ARP.

Paragraph 13 of the Stipulation provides for the continued funding at current levels of CMP's Electric Lifeline Program during the term of the ARP. The Electric Lifeline Program Reserve Account will remain in place during the term of the ARP. Any differences between the amount funded through current rates and actual benefit expenses will be deferred until the mid-period review in 1997 and treated as a passthrough item to ratepayers in that proceeding.

CMP argues that this treatment of benefit costs removes any unintended incentive that the Company might otherwise have to reduce program expenditures. We find that the treatment of the Electric Lifeline Program in the Stipulation is reasonable.

2. Restructuring Charges

At Paragraph 14, CMP commits to a write-off [10] of costs against 1994 earnings associated with Electricity Revenue Adjustment Mechanism (ERAM), deferred fuel, DSM and Wyman which would otherwise be routinely reflected in rates. This write-off is currently estimated to be about $100.5 million, or $60.4 million net of taxes. The stated purposes of the proposed write-offs are to mitigate price pressures, reduce ratepayer risk, and to better position the Company financially to meet competition. The Public Advocate argues that "while eliminating any prospect for below-the-line earnings for CMP's shareholders in 1994, this 'restructuring charge' actually enhances the prospect of healthy returns in future years."

Under the stipulated ARP, a large portion of ERAM dollars are used to fund the recovery of deferred fuel costs after the ERAM amortization is completed. This is the case even though deferred fuel and ERAM balances, among other items, are "written off." Staff notes that:

> [d]espite the write-off, it is Staff's view that ratepayers still have an obligation regarding the deferred costs. In essence, 'the write-off' is simply a means for the Company to 'move earnings around in time' so that it can more quickly return to financial health. This is accomplished by flowing earnings to the bottom line that would otherwise be designated for the recovery of regulatory assets. This approach enabled CMP

[10] During his deposition of October 27, 1994, Mr. Marsh indicated that CMP believed the terms "restructuring charges" and "write-offs" could be used interchangeably.

> to agree to lower rate levels. However, in our view, the write-off does not affect the ratepayer obligation regarding deferred costs and the rates in the stipulated ARP reflect that obligation.

CMP has stated that it would not seek recovery of these written-off costs if the ARP terminates prematurely, but reserves the right to seek recovery of these costs as part of any stranded investment charge.

The restructuring charges will benefit ratepayers in a number of ways. First, the likelihood that the profit-sharing component will result in additional price increases is reduced. Second, ratepayers will not be required to pay any remaining deferred fuel balance relating to the year-end 1994 balance in the event that the ARP terminates early. Third, ratepayers will not have to pay for carrying costs associated with fuel recovery, deferred demand-side management costs and other expenses that are written-off.

We find that the price cap plan allows the recovery of these deferred costs in a reasonable manner. The most important benefit of this voluntary write-off, in our view, is that it helps to ensure that profit-sharing will be unlikely during the term of the ARP, a result that is consistent with our concept that the profit-sharing component should provide an explicit mechanism to share extreme outcomes between ratepayers and shareholders.

3. Customer Service and Reliability Index

In our Phase I Order, we expressed concern about the effect of an alternative rate plan on the Company's continued incentive to provide high quality of service. In addition, we questioned whether our current authority to penalize the Company for an excessive number of consumer complaints or safety and reliability negligence provides an effective regulatory tool to ensure high quality service.

Paragraph 16 and Attachment G create a Customer Service and Reliability Index that is intended to give CMP an explicit incentive to provide adequate service in three broad categories: customer satisfaction, service reliability and customer service. These include two customer satisfaction indicators, two service reliability indicators, and one customer service indicator. The five benchmark indicators are:

- 82% of phone center customers surveyed think the CMP representative was knowledgeable;
- 72% of the customers surveyed respond that CMP has completed new service installations on time;
- Customer Average Interruption Duration Index (CAIDI) of 180 minutes;
- System Average Interruption Frequency Index (SAIFI) of 2.0 hours; and
- The 1993 PUC Complaint Ratio of 1.17 complaints per 1,000 customers.

Attachment G also establishes an earnings reduction mechanism with penalties ranging from $250,000 to $3 million. If CMP's net performance declines, a customer service penalty will be imposed based on a formula that is included in Attachment G. Pursuant to Attachment I, CMP will report the yearly data based on these five indicators during the annual ARP review and provide a calculation showing the performance score achieved by the Company and the resultant penalty, if any, and any change in the index that may be required either as a result of a current year penalty or the expiration of a prior year penalty. Attachment I indicates that any penalty imposed pursuant to Attachment G would be treated as a passthrough in the price cap component.

The Commission's Consumer Assistance Division (CAD) calculated the 1993 PUC Complaint Ratio using the 1993 <u>closed</u> complaint cases (582) and the total number of CMP's customers for <u>1992</u> (496,666). While we believe that a better indicator of CMP's performance is a ratio based on complaint cases <u>initiated</u> during the applicable year and the total number of Company customers for the <u>same year</u>, we are loathe to disrupt the Stipulation over this issue. We will, however, entertain from the stipulating parties any future proposal to report the Complaint Ratio, for use during the annual ARP review proceeding, based on cases initiated during the year instead of closed cases (as well as the number of customers for that same year).

The Staff asserts that the Customer Service and Reliability Index is superior to traditional regulation because specific service quality standards are established and penalties are automatically assessed if a deterioration occurs. We agree that specific service quality standards are superior to our current remedies. While we are concerned that the customer service penalty mechanism is complicated, and uses closed cases rather than initiated cases, these minor deficiencies and complexities are, under the circumstances, acceptable. We further find that the penalties in Attachment G are reasonable.

We believe that service quality and reliability are an essential element of the stipulated ARP. If the stipulated ARP is to succeed it must receive general acceptance from CMP's ratepayers and from the public at large. No ARP that substantially reduces customer service and reliability is likely to receive the ratepayer and public support that it must have. We believe that the Customer Service and Reliability Index, including the proposed baselines, will provide sufficient incentives to CMP to maintain its current levels of customer service and reliability.

4. Least Cost Planning and DSM Incentives

The major elements of the Stipulation's treatment of CMP's Least Cost Planning and Demand-Side Management (DSM) activities are found in Paragraph 17 and Attachment H. In addition, Paragraph 11 describes the flowthrough recovery of DSM costs. Paragraph 18 describes an option for reviewing or terminating the ARP should CMP's DSM efforts fail to achieve certain targets.

Pursuant to Paragraph 17, CMP will annually file savings targets for its DSM measures as part of its Least Cost Energy Resource Plan. If CMP fails to achieve 90% of its targets during a given year, the Company will be penalized, according to a schedule provided in Attachment H. The penalty will vary depending on which of the four performance bands is achieved. Any penalty assessed pursuant to Attachment H would be treated as a passthrough in the price cap component of the Stipulation. If CMP fails to achieve 90% of its DSM targets in two consecutive years, any party may petition the Commission for modification or termination of the ARP. We find that the flowthrough recovery of DSM costs also has a desirable incentive for DSM because CMP cannot profit by reducing its DSM budget.

Upon application by CMP, the Commission will complete an investigation of "Ecowatts" screening criteria appropriate for marketing under the "Ecowatts" initiative. The

Stipulation states that CMP's proposals will be consistent with the earlier work on this matter in the DSM Collaborative. Further, CMP will not advertise any use of electricity as environmentally beneficial before this investigation is completed. Attachment H.

Attachment H, page 3, presents CMP's 1995 DSM targets (or "commitments,"), which include 45,000 kWh in additional DSM savings, with increases and/or improvements in many current programs.

In the Phase I Order, we noted that an ARP, in effect, increases regulatory lag and consequently could increase CMP's opportunity to profit by promoting sales. The Order also asks whether some strengthened DSM incentives might be a desirable feature of an ARP for CMP.

We find that the penalty and recovery mechanisms in the Stipulation's treatment of DSM adequately address our Phase I concerns in this area. We further find that CMP's 1995 DSM commitment appears reasonable for the limited purpose of implementing performance targets and penalties. Annual consideration of DSM targets and limited least cost planning issues in an annual DSM proceeding is likewise a reasonable approach. We also find that the Stipulation's treatment of least cost planning and demand-side management issues is satisfactory. It indicates significant progress by the parties in resolving their differences in this difficult area. We assume that the parties will make every effort to minimize the contentiousness of DSM issues in the annual DSM proceedings, and will take every step necessary to ensure that CMP's DSM expenditures are cost effective.

5. Additional ARP-Related Proceedings

The stipulated ARP contemplates a variety of proceedings during the term of the ARP. Paragraph 20 provides for annual review proceedings that will begin each March 15 when CMP files its annual review information, and will conclude in time for implementation on July 1. Paragraph 21 calls for a mid-period ARP review to take place in 1997. During the mid-period review the Commission will "assess the overall operation and results of the ARP's performance" and consider other specific aspects of the ARP that are identified in Paragraph 21.

Paragraph 23 provides for a final ARP review in

1999 "to determine whether the ARP should continue after the end of 1999 and what changes to the ARP may be reasonable and appropriate for subsequent periods."

The stipulating parties have identified two specific instances in which the ARP can be terminated prematurely. Paragraph 18 provides that CMP may petition the Commission to terminate the ARP if the Company's actual return on equity falls outside the sharing mechanism deadband for two consecutive years. Paragraph 18 also permits any party to request termination of the ARP if CMP fails to achieve 90% of the DSM targets adopted in the Energy Resource Plan for two consecutive years.

Paragraph 17 requires CMP to file annual savings targets for the Company's DSM measures every April 1.

In addition to <u>requiring</u> several proceedings during the term of the ARP, the Stipulation explicitly <u>permits</u> certain proceedings to occur during the ARP. For instance, Paragraph 19 explicitly allows prudence reviews of CMP's operations to occur during the ARP. Attachment F permits parties to request a general rate design proceeding while the ARP is in effect. Finally, Paragraph 18 explicitly permits any non-CMP party to request a rate case during the term of the ARP.

In the Phase I Order, we expressed a desire to have brief annual ARP reviews. As discussed in detail in Part IV(C)(6) below, we find that the scope of the annual reviews in the stipulated ARP exceeds our Phase I expectations. However, in light of the magnitude of the regulatory changes inherent in the stipulated ARP, and in spite of our concerns about the timing and processing of these annual reviews, we find the scope of the Stipulation's annual ARP review is reasonable.

In our Phase I Order, we recommended an ARP performance review at the end of the plan's fourth year. Instead of a fourth year review, the stipulated ARP calls for a mid-period review in 1997 and a final review in 1999. We believe that ongoing monitoring of the ARP's performance is necessary. The mid-period review will allow us to identify and correct problems earlier than under a fourth-year review. As noted below, the extensive mid-term review contemplated by the Stipulation, combined with a final review, may require the expenditure of substantial resources by the Commission, the Company and intervenors. However, we are mindful of our ongoing responsibility to ensure that the stipulated ARP produces just and reasonable rates and find that the combination of mid-period and final reviews contained in the Stipulation is superior to the fourth-year review contemplated in our Phase I Order.

In the Phase I Order, we noted that the Commission and parties should be "strongly committed" to any ARP that is ultimately approved. However, we recognized that "there may be 'extreme circumstances' where the return to traditional ROR [regulation] may be warranted." We therefore directed the parties to identify the circumstances under which an ARP could be terminated. We find that the potential termination circumstances identified in Paragraph 18 are appropriate. Consistent with our commitment to continue to regulate CMP and monitor the reasonableness of the Company's rates during the term of the ARP, we also support the provisions of the Stipulation that permit parties to request prudence reviews, rate design reviews and rate level reviews while the ARP is in effect.

6. Accounting Authorizations

Under Generally Accepted Accounting Principles (GAAP), a regulated company that meets the criteria of SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, can follow certain accounting conventions and policies that are peculiar to regulated industries. These specific standards, coupled with a number of accounting conventions established by the Commission, have resulted in the creation of "regulatory assets." To provide the Company and its auditors with the proper level of comfort required to continue present accounting practices under SFAS No. 71 and avoid significant, unintended and unacceptable write-offs of regulatory assets, the parties to the Stipulation requested that the Commission affirm the following accounting requirements and policies. We believe that the ARP satisfies the requirements of SFAS No. 71.

a. Continued Amortization of Regulatory Assets Currently in Rates

In prior rate case proceedings, we have allowed CMP to defer costs (regulatory assets) approved by the Commission in previous base rate proceedings and currently being amortized in rates. Because the Commission already granted approval of the ratemaking treatment of these costs, the parties request that the Commission affirm the previously established deferrals and amortizations. It is our intent that these costs be collected from ratepayers. We therefore determine that this request is reasonable.

b. Fuel Accounting

The parties appear to wish to continue CMP's current fuel accounting practices. CMP's current fuel accounting involves charging actual fuel costs to expense as incurred and accruing a corresponding amount of fuel revenues. Fuel revenues accrued during the ARP will be computed as the amount specifically included in rates upon adoption of the ARP plus an amount of the annual ARP increase applicable to fuel recovery. The intent of this mechanism is to provide revenues for the recovery of specific fuel costs incurred from 1995 through 1999. Over the period of the ARP, this mechanism will create deferred fuel balances that the Company expects will be zero at the end of the ARP. However, if there is a fuel balance at the end of the five year ARP period, CMP will write off that amount. We approve this accounting treatment.

c. Demand-Side Management Costs and SFAS No. 106 Costs

Under the Stipulation, DSM costs will continue to be reconciled but annual increases will be limited to $2.0 million. Any amount above $2.0 million will be deferred and included in mandated costs in the following period. In addition, SFAS No. 106 costs will be deferred in periods subsequent to 1994 based on the mechanism demonstrated in Attachment E to the Stipulation. The treatment of DSM costs is reasonable.

Regarding SFAS No. 106 costs, Chapter 720 of our rules permits a deferral of up to 5 years only if: (1) the utility demonstrates that is not overearning for Maine-jurisdictional purposes; and (2) the utility develops a plan, which would take effect as part of rate case proceeding, to gradually phase-in the SFAS No. 106 costs for ratemaking purposes. Because CMP is not overearning and because the Stipulation's treatment of SFAS No. 106 costs is part of a phase-in plan, we approve this provision of the Stipulation. Attachment J.

d. Contract Buyout Costs

In Docket No. 92-233, [11] the Commission required the Company to defer costs incurred in restructuring its QF contracts and to record carrying costs on these deferred balances. After implementation of the ARP, CMP will begin amortizing these balances over the longer of the term of the restructured contract or the term of the original contract. Attachment C. The Company will use this same accounting procedure for all new QF contract buyouts or restructurings. If the ARP is terminated, the Stipulation requires that specific rate recognition of the remaining amortizations be granted. Attachment J. We find that this treatment is reasonable.

e. Millstone 3 Decommissioning Costs

The Company is responsible for its share (2.5%) of the decommissioning costs at Millstone 3 approved by the Connecticut Department of Public Utility Control (CDPUC). These costs are $10,533,601, $11,218,285, and $11,947,473, effective July 1994, January 1995, and January 1996, respectively. CMP is not requesting that these costs be flowed through as mandated costs.

In order for CMP to deduct its payments for income tax purposes, the Commission must recognize three things:

- the approval of the decommissioning costs established by the CDPUC;
- that the increases in payments effective in 1995 and 1996 will be included under the annual price cap increases in 1995 and 1996 for recovery; and,
- that the after-tax rate of return of 6.5% for decommissioning fund is reasonable. Attachment J.

All of the requirements listed in Attachment J are consistent with current Commission policy or have been approved in previous Commission Orders. We therefore

[11] Central Maine Power Co., Request for Accounting Order, Docket No. 92-233 (Aug. 31, 1992).

approve these accounting policies.

IV. SUMMARY OF GOALS OF THE ARP AND ANALYSIS OF WHETHER THE STIPULATED ARP IS IN CONFORMITY WITH THESE GOALS

A. Introductory Remarks

The stipulating parties assert that the ARP is a comprehensive plan that reflects a delicate balance among a variety of competing interests. Paragraph 3. In Part III above, we addressed the Stipulation on an individual component basis. Because the Stipulation is an integrated solution to a series of problems and concerns identified in the Phase I Order, it is necessary to consider the potential benefits, as well as the deficiencies, of the stipulated ARP in an integrated way.

> In the Phase I Order, we stated that: [b]ased on the evidence presented in this proceeding, the Commission finds that a multi-year plan is likely to provide a number of benefits: (1) electricity prices continue to be regulated in a comprehensible and predictable way; (2) rate predictability and stability are more likely; (3) regulatory "administration" costs can be reduced, thereby allowing for the conduct of other important regulatory activities and for CMP to expend more time and resources in managing its operations; (4) risks can be shifted to shareholders and away from ratepayers (in a way that is manageable from the utility's financial perspective); and (5) because exceptional cost management can lead to enhanced profitability for shareholders, stronger incentives for cost minimization are created.

In our Phase I Order, we articulated three additional potential benefits of an ARP. First, we found that an ARP could better accommodate the growing level of competition in the electric services industry while protecting "core customers" from subsidizing competition CMP encounters in other markets. Second, we found that an ARP could provide both short- and long-term benefits to CMP ratepayers. Third, we found that pricing flexibility, combined with a prohibition against the Company's recovering revenue deficits from customers, could provide a number of benefits.

In Part III of this Order, we examined the various components of the Stipulation and found that each independent component was reasonable. In this part of the Order, we analyze the merits of the Stipulation as an integrated whole. We also consider the potential benefits and liabilities of the stipulated ARP, test the flexibility and robustness of the Stipulation based upon quantitative and qualitative analysis, and review important legal considerations regarding the stipulated ARP.

B. Financial Analysis of the Stipulation

In our Phase I Order, we stated that we would want to assure ourselves that any new form of regulation we adopt for CMP will be likely to produce benefits to ratepayers. Further, we stated that our focus would be on a structure that will achieve the benefits we have identified while providing an equitable sharing of the risks.

In its direct case, CMP prepared a financial analysis of its proposed ARP based on a model that it developed. Following the submission of the Stipulation, CMP was directed to test the sensitivity of the stipulated ARP, utilizing the model the Company presented during the direct case. The model incorporates a set of key financial assumptions, including sales forecast, capital requirements, external financing requirements, O & M, fuel and purchase power costs. These key assumptions were updated in the stipulation-phase model based on recent developments, such as the FEV buyout, fuel savings from other recent QF buyouts or buydowns and certain other updates.

Using the updated key financial assumptions, model runs were provided based on a three percent inflation rate case with and without the write-offs identified in Paragraph 14 of the Stipulation. In order to test the robustness and flexibility of the Stipulation, six additional forecast scenarios, using the same model with the write-offs, were provided, as follows:

- a low inflation case (assumes two percent inflation, O&M costs increase at two percent annually after 1995 and short-term debt rate is decreased by one percent);

- a high inflation case (assumes six percent inflation, O&M costs increase at six percent annually after 1995 and short-term debt rate is increased by three percent);

- a low fuel cost case (assumes fuel costs consistent with the low fuel cost scenario in the April, 1994 FCA filing and decreases from base fuel cost projections of $4.7 million, $10.3 million, $10.3 million, $19.9 million and $15.3 million, in 1995 through 1999, respectively);

- a high fuel cost case (assumes fuel costs consistent with the low fuel cost scenario in the April, 1994 FCA filing and increases from base fuel cost projections of $14.4 million, $11.0 million, $10.8 million, $19.0 million and $16.6 million, in 1995 through 1999, respectively);

- a low load case (assumes reductions in fuel revenue, fuel expense and base revenue, as specified in IECG Exh. 203 at 8);

- a high load case (assumes increases in fuel revenue, fuel expense, base revenue and other expense, as specified in IECG Exh. 203 at 7-8);

These model runs provided forecasted revenue increases that would be borne by ratepayers (including profit-sharing revenue changes if the sharing mechanism were triggered) as well as key financial ratios (such as the return on equity or ROE, the interest rate coverage ratio, and the common equity ratio).

An analysis of the financial data obtained from the model runs should help verify that the ARP is likely to provide benefits for both ratepayers and the Company. From the ratepayers' point of view, the ARP should be likely to promote rate predictability and stability while shifting risk from ratepayers to shareholders. This shift in risk should be manageable from the Company's financial perspective thus creating a positive situation that can lead to enhanced profitability if the Company manages its costs efficiently. In addition, an ARP should have the robustness and flexibility needed to succeed in a number of different future environments.

Table 2 below provides the projected price increases to ratepayers based on the model runs provided by CMP, each forecast scenario includes the 1994 write-offs due to restructuring charges.

TABLE 2

PROJECTED INDEX RATE INCREASE UNDER VARIOUS SCENARIOS

FORECAST SCENARIO	1995	1996	1997	1998	1999
3% Inflation	2.5%	2.5%	1.6%	1.4%	1.4%
2% Inflation	1.5	1.5	1.0	0.7	0.7
6% Inflation	5.5	4.0	3.5	2.6	2.4
Low Fuel Cost	2.5	2.5	1.6	1.4	1.4
High Fuel Cost	2.5	2.5	1.6	1.4	1.4
Low Load	2.5	2.6	1.6	1.3	1.1
High Load	2.5	2.5	1.6	1.3	1.1

The model run with a three percent inflation rate fulfills our stated criteria. Under the three percent case with the write-offs, prices would potentially increase by 2.5% in 1995 and 1996 with a 5-year average increase of 1.9%. The profit-sharing mechanism is never triggered throughout the 5-year period. In addition, the Company's financial integrity improves in every year with gradual improvements in CMP's ROE, interest coverage and common equity ratio. While the common equity ratio is projected to increase to a level above 50% by 1998, the 50% cap on the common equity ratio, for the purpose of the profit-sharing component, adequately protects ratepayers. In practice, CMP can manage its equity ratio to keep it below 50%.

The three percent model run without the write-offs in 1994 is the most significant in terms of assessing CMP's financial performance. Because CMP's ratepayers would normally bear all of the approximately $100.5 million of deferred items under an ARP, CMP's financial performance should be assessed as if CMP did not take the write-off. Under the three percent case without the write-offs, CMP's earned ROE would remain below its current allowed return in all years of the ARP.

In the low (two percent) inflation case, rate increases to ratepayers do not exceed 1.5% and the average increase is 1.1% over the 5-year period while CMP's financial performance gradually improves. While the common equity ratio is projected to increase to a level above 50% by 1998, the 50% cap on the common equity ratio, for the purpose of the profit-sharing component, adequately protects ratepayers.

In the high (six percent) inflation case, price increases average 3.86% over the 5-year period and never exceed 5.5% (which occurs only once in 1995). In the later years, price increases are moderated by the sharing mechanism which keeps prices from increasing beyond 2.6%. From the shareholders' perspective, the model run suggests that CMP would earn a relatively high ROE and rapidly increase its common equity ratio. However, there have been only two occasions, since 1920, where inflation has been above six percent for 5 consecutive years or more.

In both the high fuel cost case and the low fuel cost case, price increases average 1.95% over the 5-year period and do not exceed the 2.5% increase of the original case. While the two fuel cases are equivalent from the perspective of ratepayers, for shareholders the low fuel case is much preferred because all of the fuel savings flow to the benefit of shareholders.

In the two load growth cases, price increases are moderate (1.89% on average in both cases) and financial ratios all show steady improvement. The sharing mechanism, however, is triggered in both load cases. In the high load case, price increases are reduced in 1998 and 1999 as earnings exceed the ±350-basis-point bandwidth. The opposite is true in the low load case where prices are increased modestly ($0.5 million) in 1996. From the perspective of shareholders, the load cases suggest that load growth would be beneficial. As a result of high load growth, revenues increase more than expenses, resulting in improved profitability. In the high load case the common equity ratio is projected to increase to a level well above 50% by 1998.

Based on a review of the financial data from the various model runs contained in the record, the stipulated ARP appears to be robust over a broad range of assumptions.

C. Qualitative Analysis of the Stipulation

1. Ongoing Regulation of CMP's Rates

In the Phase I Order, we stressed that under an ARP, CMP's rates should "continue to be regulated in a comprehensible and predictable way." We acknowledge at the outset that the implementation of the stipulated ARP will not remove all confusion and uncertainty about CMP's rates for the next 5 years. The stipulated ARP represents a significant shift in the way CMP's rates will be regulated. Such shifts, particularly in their initial stages, can raise questions that were not previously asked. However, on balance, we find that the stipulated ARP will produce a regulatory scheme that is more understandable and more predictable than traditional ROR regulation.

In addition, we find that regulation under the stipulated ARP will be as comprehensive as ROR regulation. We are mindful of concerns raised by the Public Advocate in the earlier stages of this proceeding, and echoed by members of the public during the public witness hearings, that an ARP may result in regulation on "automatic pilot." As discussed below, Commission oversight of CMP's rates under the stipulated ARP is substantial. We concur with the Public Advocate's assessment that the stipulated ARP "involves no diminishment of the Commission's oversight of CMP's operations but rather the creation of new tools to accomplish its historic mission ... ." (emphasis in original).

Under the stipulated ARP:

- The Commission will continue to have oversight over CMP's rates through the annual review proceeding each year. This proceeding will provide a needed opportunity to review the appropriateness of rate changes under the Stipulation.

- During the term of the ARP, there will be only one rate change per year, on July 1. This is an improvement over the unpredictable timing of rate changes under traditional ROR regulation.

- The level of rate changes during the ARP will be more predictable. Ratepayers who must do long-term advance planning will be able to make more informed decisions under the ARP. While the exact level of future rate increases under the ARP is not specified, the formula will likely produce a result in each year that is below the rate of inflation, as measured by the GDP-PI index.

- While the pricing flexibility provisions will allow CMP to make some rate level changes without extensive review by the Commission, unusual or significant rate design changes will continue to require Commission approval.

- Through its continuing authority over CMP's least cost planning activities, the Commission will continue to seek to assure that CMP conducts its resource planning in a least cost manner.

- The Commission has significant discretion to terminate the ARP if it is not working as planned. In addition, parties can request an investigation into rate levels, rate design and prudence during the term of the ARP. While we intend to allow the ARP to operate as planned, as long as it is working as intended, this discretion provides an assurance that unintended consequences will not result.

We are committed to regulating CMP in a way that is both comprehensible to the public and comprehensive in nature. We believe that the Stipulation is consistent with that commitment.

2. Rate Predictability and Stability

In the Phase I Order, we stated that rates should be more predictable and stable under an ARP than under ROR regulation. For a number of years there has been a consistent message from the public: dissatisfaction with rapidly increasing rates. That was a consistent message heard during the "ratepayer revolt" case and the Phase I case in this proceeding. That was also a message that was presented during the public witness hearings in this case.

Our review of the Stipulation indicates that improved rate stability and predictability are likely under the ARP. This assertion is supported by the following facts:

- The financial analysis, see Part IV(B) above, suggests that the stipulated ARP will likely produce stable and predictable rates. The financial analysis further indicates that the ARP is likely to have the robustness and flexibility needed to operate adequately in a number of different future environments.

- The pricing flexibility component, which will increase CMP's ability to retain or attract customers, is likely to be beneficial by helping CMP to avoid uneconomic bypass of its system. While there is a potential downside, the Revenue Delta Cap will help to limit that risk to ratepayers.

- CMP has voluntarily waived certain of its rights, such as the right to file a rate case during the term of the ARP. This stayout agreement has generated a number of benefits that will lead to more predictable and stable rates under the ARP. On the one hand it provides the assurance that the incentives for efficiency included in the ARP will have an opportunity to work as intended. On the other hand, it does not restrict other parties from requesting an investigation of rates by the Commission.

3. Risk Shifting

Under traditional ROR regulation, ratepayers bear many risks. In our Phase I Order, we found that a problem with traditional regulation was that it allowed CMP to pass through to its customers the risks associated with inefficient management decisions and actions as well as the risk associated with economic fluctuations.

Under the Stipulation, CMP will have both significantly increased risk and potential reward. For example, CMP will bear the risk that costs will rise faster than the index; the risk of lost sales due to weather, economic conditions or competition; and the risk that discounted rates would decrease the Company's overall net revenue.

The Commission currently has the ability to penalize a utility for management imprudence. Unfortunately, however, after-the-fact prudence disallowances have limitations. Most notably, the level of appropriate disallowance may be so great that its implementation would impair the utility's financial integrity, which would in turn harm ratepayers. The risk transference framework embodied in the Stipulation presents an improvement over that model. Because CMP will bear most of the risk of poor performance, CMP has a greater incentive to engage in "preventive maintenance" to avoid management imprudence in the first place. If this occurs, CMP's ratepayers will gain a major long-term benefit. We further note that CMP's voluntary agreement to bear increased risk under the Stipulation provides us with some indication that CMP has begun to move in the direction of proactive and responsible management of its operations.

4. Incentives for Cost Minimization

In the Phase I Order, CMP was found to have been inefficiently managed. These deficiencies were reflected in the $25.3 million management efficiency adjustment.

In our Phase I Order, we noted that traditional ROR regulation provides a weak incentive for efficient operations and investments. The Stipulated ARP will force the Company to bear the consequences of poor decisions and will allow it to retain the benefit of good decisions. Ratepayers share in the benefits of improved incentives through the substantial productivity offset that is included in the Stipulation. These outcomes are consistent with the principles that we articulated in our Phase I Order.

5. Simultaneous Accommodation of Competition and Protection of Core Customers

We agree that the Stipulation provides CMP's core customers with a "regulatory insurance policy" against uncertainties. In an uncertain and turbulent electric utility environment, the price cap provides substantial protection to core customers. The lost revenues associated with customers leaving the system will not automatically fall on the shoulders of remaining customers as would be the case under traditional regulation. Core customers, therefore, are the primary beneficiaries of the price cap regulation inherent in the ARP.

We find that one of the most important benefits of the stipulated ARP is that it provides CMP's core customers with predictable and stable rate increases below inflation for the next 5 years. During the term of the ARP, we will take whatever steps we can to ensure that this rate predictability and stability feature of the ARP is not compromised. For instance, we will closely scrutinize all requests for "mandated cost" recoveries as well as any claims of changed circumstances that may undermine the predictability and stability of rates for core customers while the ARP is in effect.

6. Regulatory Cost Implications of the Stipulated ARP

In the Phase I Order, we identified five basic problems associated with the continuation of traditional ROR regulation. Included in this list of problems was "the high administrative costs for the Commission and intervening parties from the continuous filing of requests for rate changes." Based on the Phase I record, we found that a properly structured multi-year price cap plan is likely to provide a number of potential benefits including the possibility that "regulatory 'administration' costs can be reduced, thereby allowing for the conduct of other important regulatory activities and for CMP to expend more time and resources in managing its operations."

Several paragraphs of the Stipulation affect the regulatory costs that will likely be incurred by CMP, the Commission and intervening parties under an ARP regime. Those provisions include Paragraph 20 (annual review); Paragraph 21 (mid-period review); Paragraph 23 (final review); Paragraph 18 (termination of ARP); Paragraph 19 (prudence reviews); Paragraph 11 (cost recovery for DSM and SFAS 106); Paragraph 15 (flexible pricing); and Paragraph 17 (least cost planning and DSM).

In this section, we discuss the number, scope and timing of the various proceedings required by the stipulated ARP, assess the regulatory cost of these ARP proceedings and compare those costs with comparable regulatory costs that would likely occur under traditional ROR regulation. Based on this comparison, we find that the regulatory costs under both ROR regulation and the stipulated ARP for the next 5 years are likely to be substantial. We also find that there is much uncertainty about the frequency, scope, and timing of proceedings that will be required during the term of the ARP. While we are concerned that moving from ROR regulation to regulation under the stipulated ARP will not result in short-term reductions in regulatory costs for either CMP, the Commission or intervening parties, we believe that there is a reasonable prospect for reductions in the long term.

a. Annual Reviews

In the Phase I Order, we found that the lack of an annual review was a "significant shortcoming" of CMP's plan and the inclusion of an annual review a "strength" of the CCUC plan. We found, however, that a "major weakness" of the CCUC plan was that it contemplated "an annual review process that would encompass a too-broad an array of issues." In providing guidance to the parties in the Phase I Order, we stated that the annual reviews should be brief, and urged that the scope of the annual review be "restricted to determining the mandated costs that can be passed through to consumers, verifying the profit-sharing and price-cap rate adjustments, and evaluating the quality-of-service performance during the previous year."

Paragraph 20 of the Stipulation requires CMP to file information on the following subjects each March 15 during the term of the ARP:

(i) price index

(ii) earnings sharing, if any

(iii) flow through items, including net savings associated with QF contract restructuring sharing mechanism

(iv) pricing flexibility

(v) limited review of updated estimates of marginal cost

(vi) review of customer service and reliability performance criteria

(vii) review of compliance with demand-side management targets

(viii) review of CMP's overall compliance with provisions of the ARP.

Also included in the annual revenue will be SFAS No. 106 costs (Paragraph 11), a review of CMP's Revenue Delta Caps (Attachment F at 9), and a review of CMP's load growth efforts (Attachment F at 10). Other Paragraphs of, and Attachments to, the Stipulation give further clues as to what the annual ARP reviews will entail. For instance, page 1 of Attachment H makes clear that the parties expect to "fully participate and litigate their positions" on CMP's 1995 Energy Resource Plan. Similarly, Attachment F at 3 clarifies that the "parties will have an opportunity to examine and dispute" CMP's updated estimates of its long-run marginal costs during the ARP annual revenue and "propose modifications to the updates proposed by the Company."

Citing Attachment I, CMP in its Brief acknowledges that the scope of the annual review contemplated by the Stipulation is broader than the annual review recommended by the Commission in the Phase I Order.

Our review of the Stipulation suggests that the annual review will be more comprehensive than we anticipated in our Phase I Order. It will be broader in scope and will include diverse issues that could produce active litigation.

The Stipulation provides 3.5 months for the annual review. To address our concerns about our ability to complete the review in a timely way, we direct the stipulating parties to prepare a comprehensive list of issues that they believe should be considered in the 1995 ARP annual review proceeding.[12] We also direct the stipulating parties to prepare a draft schedule for the 1995 ARP annual review proceeding that is consistent with the Stipulation and incorporates a March 15 filing date and a July 1 implementation date. The stipulating parties shall file the list of issues and schedule on or before February 14, 1995.

b. Mid-Period and Final Reviews

To ensure that the long-term reductions in regulatory costs that we anticipate are, in fact, achievable, we will direct the stipulating parties to file an explanation of the

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[12] In its Exceptions to the Examiners Report, the Public Advocate asserted that parties and non-parties who did not sign the Stipulation should be involved in preparing this list of issues and other lists and reports required in parts b and c below. Our desire here, and in parts b and c below, is to direct the stipulating parties to provide details about their agreement that were not specifically addressed in the Stipulation. If we are to administer the stipulation, we need to know what the stipulating parties intended. We note that the list of issues filed by the stipulating parties pursuant to this section will not be the only factor controlling the scope of the annual ARP reviews. Other parties (like ABC) or non-parties (like the Natural Resources Council of Maine) may comment at any time regarding the proper scope of annual ARP reviews or other ARP proceedings discussed in parts b and c below.

substantive and scheduling relationships between the mid-period and final reviews and other reviews, proceedings and investigations contemplated by the Stipulation. This explanation is also due on February 14, 1995. In this explanation, the stipulating parties should also discuss when they anticipate the mid-period and final reviews beginning and ending and that they expect to be within the scope of those reviews.

c. Additional Proceedings

The Stipulation either explicitly or implicitly contemplates the initiation and completion of many additional proceedings involving CMP during the term of the ARP.

(i) Compliance Proceeding

The Stipulating parties refer to a "compliance proceeding" in Attachment F in conjunction with the pricing flexibility component of the ARP. The Stipulation anticipates that CMP's filing requirements and a service list will be "pre-determined" during the compliance proceeding. Attachment F at 3, fn. 5. Attachment G also refers to a "compliance phase of the ARP proceeding" during which interruptions related to major storms will be removed from reported outage data used to evaluate CMP's service reliability. The Stipulation provides no further guidance as to when this compliance proceeding will take place or what other issues will be addressed during the proceeding. The stipulating parties shall, on or before January 17, 1995, file a discussion of the scope and timing of the "compliance proceeding" referenced in Attachments F and G.

(ii) Termination Proceeding

Paragraph 18 identifies two circumstances in which the ARP can be terminated before the expiration of its 5-year life. First, if the Company's actual return on equity falls outside of the sharing mechanism deadband for two consecutive years, then CMP may "petition the Commission for review of rates, revenue requirements and the overall ARP." Second, if the Company fails to achieve 90% of the DSM targets adopted in the Energy Resource Plan for two consecutive years, then any party may "petition for a Commission revision or termination of the ARP." [13]

(iii) Rate Case Proceeding

Paragraph 18 also makes clear that any party, other than CMP, may petition the Commission for a review of the Company's rates during the term of the ARP.

(iv) Pricing Flexibility Proceedings

Paragraph 15 and Attachment F of the Stipulation address pricing flexibility and related proceedings during the ARP. In Paragraph 15, the stipulating parties indicate that they intend "that the issue of 'interim floor prices' be resolved by January 1, 1995." Paragraph 15 also provides that "if unresolved, the Company will have the right to petition the Commission for a decision on this issue." It is not clear whether the stipulating parties intend to resolve this issue in a compliance phase of this case or in a separate proceeding. [14] Paragraph 15 also provides that "if unresolved, the Company will have the right to petition the Commission for a decision on this issue." It is also unclear how the revised schedules and Memorandum of Agreement filed by CMP pursuant to Attachment F on November 22, 1994, affects the timing of and need for disposition of this issue. On or before January 17, 1995, the stipulating parties shall file a discussion of when and in what proceeding they propose to resolve open issues relating to the issue of interim floor prices.

Under Attachment F, the Commission will have 4 months to review any pricing flexibility plan that does not meet the criteria set forth in Attachment F and any long-term special rate contract. The Commission will have 30 days to determine if pricing flexibility plans for (1) existing customer classes; (2) new customer classes for optional targeted service that induce permanent load; or (3) short-term special rate contracts with individual customers meet the criteria of Attachment F. Attachment F also provides that "[i]n the event

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[13]CMP has expressed its intent to promptly file for fuel cost recovery if the ARP were terminated.

[14]In our Short Order, dated December 30, 1994, we approved the interim floor prices for the LGS-ST-TOU and LGS-T-TOU rate classes that were stipulated to by CMP, the Advocacy Staff and the OPA and filed by CMP on December 13, 1994.

the Revenue Delta Cap is reached, or appears likely to be reached, the Company must petition the Commission for authority to continue to offer discounted rates."

(v) Least Cost Planning and DSM Reviews

Under Paragraph 17, CMP will file annual savings targets for the Company's DSM measures consistent with its Least Cost Energy Resource Plan on April 1, 1995. These annual savings targets "will be updated annually and subject to approval by the Commission." CMP describes the DSM target proceedings as follows:

> These proceedings will begin on April 1 of each year when the Company files its energy resource plan. The filing and subsequent proceeding should include the approach taken to accomplish least cost planning, the methods for determining and meeting the Company's resource needs and recommended DSM approvals for accomplishing least cost business goals. Approval may well occur in stages, with approval of the planning approach addressed first, followed by approval of general methods for meeting DSM savings targets. The timing of the proceeding will be determined by the Commission.

The Staff "anticipates that the DSM targets will be reviewed in the context of least cost planning. The focus, however, will be on DSM. Broader least cost planning issues will be reviewed in other proceedings (i.e., avoided cost or certificate proceedings)." The OPA asserts that these DSM target proceedings are "expected to be resolved in time for recognition in the July 1 ARP rate adjustment. A similar time period has been used in fuel adjustment cases over the past ten ... or more years." Thus, it appears that the DSM target proceedings will be litigated at precisely the same time the ARP annual reviews are taking place. On or before February 14, 1995, the stipulating parties shall file further discussion of the timing and scope of the DSM target proceedings, an explanation of whether the DSM target proceedings will take place at the same time as other ARP-related proceedings, such as the annual reviews, and an assessment of whether any overlap of ARP-related proceedings will create resource problems for any of the parties.

d. Analysis of ARP's Regulatory Cost Implications

There are numerous uncertainties regarding the short- and long-term impact of the ARP on the regulatory costs associated with regulating CMP. The uncertainties about the frequency, scope and duration of future proceedings under any regulatory regime make it difficult to quantify and compare regulatory costs under alternative forms of regulation. Indeed, the parties spent little time in this proceeding attempting such quantification and comparison.

Based on our review of the record and the provisions of the Stipulation, we are concerned that the resources that will be spent under the ARP by the Commission, CMP and intervenors in the annual reviews, mid-period and final reviews, a compliance proceeding, pricing flexibility proceedings, least cost planning and DSM reviews, combined with the resources that may be spent under the ARP on a possible Ecowatts investigation, rate design proceedings, prudence reviews, termination proceedings and rate case proceedings will not be significantly less than the resources that would have been spent for the same period of time under ROR regulation.

In spite of these concerns, we believe that the stipulated ARP is consistent with our overall objectives concerning efficient regulation and should be approved. We also agree with the Public Advocate that "[w]ithout active and ongoing participation of the Commission, the Stipulation's price cap mechanism simply can't function successfully" and that "the Commission will be fully engaged in monitoring, implementing and - where necessary - modifying the ARP over the 1995-1999 period."

While we are concerned about the limited short-term regulatory cost savings, we believe that there is a reasonable prospect of regulatory cost savings in the long-term. Future regulatory plan proceedings will have the benefit of the experience that has been developed during the period of this ARP. Consequently, many of the protective requirements may no longer be needed. While we believe that long-term regulatory cost savings are reasonably likely to be achievable, we recognize our obligation to do what we can to ensure that these cost savings are, in fact, achieved.

7. Concerns Raised by the ABC

The ABC is the only party in this case to oppose the Stipulation. In its Brief, the ABC raises four concerns about the Stipulation. These concerns echo concerns raised by IECG witness Richard Silkman in the earlier stages of the Phase II proceeding.

The ABC cites Dr. Silkman's concern that the Commission should not depart from ROR regulation of CMP until the Company's financial position is "stable, predictable and certain." However, the financial analysis (see Part IV(B) above), indicates that the ARP is sufficiently robust and flexible to permit CMP to perform adequately under a number of different potential future circumstances.

The ABC questions whether CMP's management has the skills necessary to function effectively under an ARP. We acknowledge that the stipulated ARP is to some extent an experiment that will test CMP's management's ability and performance. Our quantitative and qualitative analysis of the stipulated ARP convinces us that it is reasonable to undertake this experiment at this time. If CMP fails to perform adequately under the ARP, the Commission will have ample opportunities to modify, and if necessary terminate, the ARP.

The ABC is concerned that additional competition, such as retail wheeling, is not introduced under the ARP. We view the ARP as an incremental step toward a more competitive environment in which electric utility ratepayers enjoy reasonable safeguards. We believe that the ARP, which is intended to improve CMP's ability to meet competition, is a reasonable step for the Company at this time.

The ABC cites Dr. Silkman's argument that the public must be certain that an ARP will result in lower rates over the long term. While we cannot be absolutely certain that lower rates will be achieved under the Stipulation than would have been achieved under ROR regulation, we expect that the Stipulation will produce lower rates for customers during the term of the ARP than under traditional regulation.

8. Concerns Raised by the NRCM

We are not persuaded by the arguments filed by the Natural Resources Council of Maine (NRCM) on the stipulated ARP. Although NRCM is not a party to this proceeding, it filed comments on December 1, 1994, pursuant to a request by Chairman Welch at a public witness hearing on September 19, 1994. NRCM was asked to submit written comments addressing the ARP and potential conflicts with State law and energy policy.

Specifically, as we discuss later in Part IV(D) below, we do not believe that there is any statutory problem associated with approving the stipulated ARP. Further, we believe that the DSM provisions in the ARP are quite strong. Finally, we will continue to have broad authority over least cost planning, DSM and other regulatory issues and, if we find it necessary in the future, we can review DSM and least cost planning incentives under the ARP and make any appropriate changes.

D. Commission's Authority to Adopt an ARP for CMP

In 1991, the Legislature enacted legislation codified at 35-A M.R.S.A. § 3195 that clarifies Commission authority regarding incentive ratemaking and the promotion of electric utility efficiency. [15] Subsection 3195(1) makes explicit the Commission's authority to establish or authorize "any reasonable rate-adjustment mechanisms to promote efficiency in electric utility operations and least-cost planning" and lists four types of permissible mechanisms. These mechanisms include "adjustment of revenues based on reconciled, indexed or forecasted costs" (subsection 3195(1)(C)) and "positive or negative financial incentives for efficient operations." Subsection 3195(1)(D). Subsection 3195(2) requires that rates resulting from the implementation of such rate adjustment mechanisms must be just and reasonable.

In 1994, the Legislature added a subsection to section 3195 entitled "rate flexibility." [16] Subsection 3195(6) clarifies that the Commission may authorize an electric utility to implement a pricing flexibility program that includes changing rate schedules and entering into special rate contracts with limited notice and approval. Subsection 3195(6) further provides that "as part of a program adopted under this subsection, the Commission may waive the requirements of section 3101 [the fuel adjustment clause]."

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[15] P.L. 1991, c.413 created subchapter VII of Chapter 31 of Title 35-A. Section 3195 is entitled "Commission authority to promote electric utility efficiency."

[16] P.L. 1993, c.614 grew out of L.D. 1666 entitled AN ACT to Permit Electric Utilities Greater Flexibility in Adjusting Electric Utility Prices to Meet Changing Market Conditions.

Staff argues that section 3195 "was enacted to make it clear that nothing in Title 35-A prohibits the Commission from adopting precisely the kind of rate cap mechanism that is included in the stipulated ARP." Staff further argues that subsection 3195(6) "contemplates the type of pricing flexibility provided in the stipulated ARP." Other parties concur.

We find that section 3195 explicitly articulates the Commission's authority to adopt rate adjustment mechanisms such as the ones contained in the stipulated ARP. As explained earlier in this Order, we find that the record in this case provides substantial evidence that the rates anticipated under the stipulated ARP are just and reasonable, that the stipulated ARP provides substantial safeguards in the event that foreseen or unforeseen circumstances jeopardize the justness and reasonableness of rates during the term of the ARP and that risks are shifted from CMP's customers to the Company. We further find that the stipulated ARP is not inconsistent with any other provision in Title 35-A, including but not limited to the Commission's general ratemaking authority in Chapter 3, the provisions governing the regulation and control of public utilities under Chapter 7, State energy policy codified in the Electric Rate Reform Act (section 3152 et seq.), and the Maine Energy Policy Act (section 3191) and with recently enacted provisions such as section 3156 (certificates of approval for electric rate stabilization agreements) and Chapter 44 (Maine Surplus Energy Auction Program).

V. PROPOSED SCHEDULES AND 5-YEAR CONTRACTS

A. Introduction

On November 22, 1994, CMP filed a two-part program proposal pursuant to the Flexible Pricing terms to the then-pending ARP Stipulation. Pursuant to Attachment F, section I of the stipulated ARP, CMP filed revised rate schedules for rates LGS-ST-TOU and LGS-T-TOU. [17] Pursuant to Attachment F, section III(B)(4) of the stipulated ARP, CMP filed a Memorandum of Agreement to be executed by customers in the LGS-ST-TOU and LGS-T-TOU classes who wish to fix the rates charged by CMP for

[17] On December 13, 1994, CMP withdrew its proposed revision to page 80.00 of the LGS-ST-TOU Rate Schedule.

electrical service over a 5-year period ("5-year contracts").[18] The proposed schedules and Memorandum of Agreement were filed as a two-part program that was contingent upon PUC approval of the stipulated ARP.

Also on November 22, CMP and the IECG filed a Motion requesting the Commission to consider the proposed schedules and 5-year contracts at the same time we deliberate the merits of the stipulated ARP. In its November 22 Motion, CMP and the IECG also requested the Commission to issue certain waivers and findings that would allow the proposed schedules and 5-year contracts to take effect at the same time the stipulated ARP takes effect.

In our Summary and Decision and Order issued in this case on December 30, 1994 ("Short Order"), we provided the various waivers and findings requested by CMP and the IECG in their November 22 Motion. In our Short Order, we also found CMP's revised rate schedules for rates LGS-ST-TOU and LGS-T-TOU to be consistent with the provisions of the stipulated ARP and allowed those schedules to take effect on January 1, 1995. We further found that the Standard Form Contracts filed by CMP on December 19, 1994, are consistent with the provisions of the stipulated ARP and not anti-competitive or unduly discriminatory. Finally, in the Short Order we delegated authority to the Director of our Technical Analysis Division to review all executed Customer Service Agreements filed pursuant to the program initiated by CMP in its November 22 filling in this case.

In this section, we discuss CMP's revised rate schedules, CMP's proposed 5-year contracts and comments on the proposed schedules and contracts that were filed by parties and non-parties to this proceeding. In this section, we also summarize the notice and comment procedure followed by CMP regarding its proposed schedules and 5-year contracts and the procedures that the Commission has followed, and will follow, regarding the two-part program that CMP filed on November 22, 1994.

B. CMP's Notice and Comment Procedure

Paragraph 15 of the Stipulation deals with pricing flexibility for CMP during the term of the ARP. Attachment F to the Stipulation sets forth the terms and conditions that govern

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[18] The November 22 Memorandum of Agreement was updated by Standard Form Contracts filed by CMP on December 8 and 19, 1994.

CMP's pricing flexibility authority. Section I(F) of Attachment F provides in part that:

> [t]he Company must file any proposed change to an existing rate schedule with an effective date 30 days from filing. The proposed rate schedule, along with pre-determined filing requirements, will be served on a pre-determined service list. Parties will have 14 days to file written comments or objections. The Commission will suspend a proposed rate schedule only if it does not conform to the ARP requirements.

Section III(B)(4) of the Stipulation governs the filing of short-term special rate contracts and also contains a 30-day review period and a 14-day comment period.

In its November 22 filing, CMP described the notice and comment procedures it intended to follow regarding its proposed schedules and 5-year contracts. On November 22, the Company sent written notice of its proposed schedules and 5-year contracts to approximately 1,930 CMP customers in the MGS, IGS and LGS classes with demand in excess of 100 kW. [19] CMP's written customer notice described its proposed schedules and 5-year contracts and indicated that any customer may submit comments or objections on these matters on or before December 7, 1994. In its November 22 filing, CMP requested that the proposed schedules and 5-year contracts take effect on January 1, 1995.

In approving the Stipulation, we found that the notice and comment period for pricing flexibility proposals was reasonable. The procedure followed by CMP regarding its November 22 filing included broad dissemination of written notice, more than 14 days for written comments and more than 30 days before the proposed schedules and contracts were to take effect. We find that the notice and comment procedure followed by CMP regarding its November 22 filing is sufficiently consistent with the procedure established in the Stipulation. In our Short Order, we identified areas where CMP's procedure

[19] CMP asserted that in the absence of the pre-determined mailing list that was anticipated in the Stipulation but had not yet been assembled, this broad mailing to all customers in excess of 100 kW was reasonable.

deviated from the procedure established in the Stipulation and granted waivers to accommodate those deviations.

The Commission received written comments from seven interested persons in response to CMP's notice. Responsive comments were filed by four parties in this case. These comments and responses, along with CMP's proposed schedules and 5-year contracts, are discussed below.

C. Revised Rate Schedules for Rates LGS-ST-TOU and LGS-T-TOU

The proposed schedules for rates LGS-ST-TOU and LGS-T-TOU filed by CMP on November 22 were submitted pursuant to Attachment F, section I, of the Stipulation. Pursuant to Attachment F "[p]ricing changes that satisfy specific criteria will be effective without Commission approval." The applicable criteria are set forth on pages 1-3 of Attachment F.

1. Positions of the Parties

In its November 22 filing, CMP provided workpapers that are designated to "demonstrate that the change in ratio of revenue from rate element to total class revenue does not exceed the 20% required relationship [of Attachment F, section I(c)(1)]." CMP further asserts that the "proposed floors compared with the rates [demonstrate] that the rates do not fall below the floor." CMP further asserts that the workpapers also address the "long-term marginal costs compared with the 15% core rate reduction [Attachment F, section I]" and the "computation of the '60% floor' [Attachment F, section I(B)]." In its November 22 filing, CMP asserts that "[e]xcept with respect to the filing and notice requirements [discussed above] the proposed rate schedules meet the proposed terms of the ARP."

In their Joint Motion filed on November 22, CMP, the OPA, the IECG and the CCUC represent that they "are of the opinion that the Initial Rate Schedules ... conform with the pricing flexibility provisions for Existing Customer Classes and for Special Rate Contracts with Individual Customers, respectively, ... and that they are not anti-competitive or unduly discriminatory."

In Comments filed on December 14, the Advocate Staff represents that "the Company's proposed revisions to its LGS-ST-TOU and LGS-T-TOU rate schedules comply with the ARP pricing flexibility criteria contained in Attachment F, sections I, I(A), I(B) and I(C)" of the stipulated ARP.

2. Comments from the Public

The Commission received comments on CMP's proposed schedule revisions from five members of the public. On November 29, 1994, Fox 51 filed a letter in which it notes that "[i]f we qualify for the CMP reduction, then we are all for the revised rate schedule. However, if we do not qualify then we strenuously object to this proposal." Fox 51 asserts that it is dissatisfied with the current rate CMP charges it for electricity and that Fox 51 has been considering installing diesel generators or wind towers so that it can terminate its relationship with CMP. Fox 51 concludes that if it is not given a rate reduction it will leave CMP's system.

On December 1, 1994, Thomas College filed comments supporting CMP's proposed schedule revisions. Thomas College's support appears to be premised on the misunderstanding that the proposed schedule revisions would result in a rate reduction for the College.

On December 9, 1994, Smugglers Cove Motel filed comments opposing CMP's proposed schedule revisions. Smugglers Cove Motel's opposition appears to be based on the false assumption that the proposed rate reduction for LGS-ST-TOU and LGS-T-TOU customers will somehow encourage those customers to bypass CMP's system. The Motel concludes that CMP's proposal will result in higher rates for commercial and residential customers.

On December 12, 1994, CMP filed a letter responding to the three letters discussed above. In its December 12 letter, CMP clarifies that because neither Fox 51 nor Thomas College is an LGS-T-TOU or LGS-T-TOU customer, neither qualifies for the rate reduction contained in the Company's November 22 filing. In response to the comments of Smugglers Cove Motel, CMP argued that the Motel's comments

> are based on the false premise that by reducing prices for large industrial customers in exchange for fixed term contracts, other customers will "pay the bill." Under the ARP, the price cap mechanism provides protection for ratepayers from such cost shifting. The 350 basis point deadband provides ample insurance that other

> customers will not pay the costs of the reduced prices for industrial customers. Further, it should be noted that, even without the ARP, price reductions in exchange for five-year commitments could well prevent, rather than cause, the revenue erosion concerns raised by Smugglers Cove Motel.

CMP's response to letters of Fox 51, Thomas College and Smugglers Cove Motel is sufficient. None of these letters raises any persuasive grounds for rejecting CMP's proposed revisions to the schedules for rates LGS-ST-TOU and LGS-T-TOU. However, each of these letters does reveal a significant amount of confusion and uncertainty about the coverage and impact of CMP's proposed schedules and 5-year contracts. In any future notice issued pursuant to the pricing flexibility provisions of the ARP, CMP should take care to anticipate, clarify, and thereby avoid whenever possible, potential areas of uncertainty such as those revealed in the three letters discussed above. We expect that in many instances, such confusion can be avoided by including more information in the notice itself. In addition, it may be useful for CMP to include in its notice, a telephone number that customers can call to ask questions about the notice and the pricing flexibility proposal in question.

In addition to the three letters above, the Commission received letters from UAH-Hydro Kennebec Limited Partnership (UAH) and the City of Westbrook objecting to CMP's proposed schedules because of their effect on "Scott-type" contracts.[20]

On December 12, UAH filed a petition to intervene and Comments on the ARP Stipulation. In its Comments, UAH asserts that the proposed schedules (1) "constitute a breach of contract;" (2) "contravene the Commission's ruling in Docket No. 93-076;" and (3) "violate the provisions of 35-A M.R.S.A. § 3309." UAH argues that:

> [t]he only explanation that UAH can discern for the drastic rate reductions for the

[20]Under a "Scott-type contract," CMP purchases power at rates that track upward or downward adjustments in retail rates charged by CMP to certain industrial customers.

> LGS-ST-TOU and LGS-T-TOU rate classes is that CMP is counting on fuel cost savings under the Scott-type contracts to finance its efforts to shore up its industrial base and better position itself for a competitive power market.

In an effort to protect its contract from what it argues is "artificial manipulation," UAH requests the following alternative forms of relief:

> First, the Commission should condition its approval of the ARP Stipulation on CMP's agreement to modify UAH's contract to fit the new regulatory environment. UAH is not asking the Commission to make a contract determination, or to order CMP to modify its contract with UAH, but merely to impose a condition to the ARP Stipulation that makes the Stipulation fair and equitable to UAH. For this purpose, UAH will agree to fix its rates at current levels, and to modify the pricing provision so that it tracks the price cap of the ARP Stipulation while the ARP is in effect.
>
> Alternatively, UAH requests that the Commission modify Section I of appendix F to preclude any <u>downward</u> adjustment of a rate class if CMP is offering special rate contracts to members of that rate class. In cases where CMP already is offering special rate contracts, as it currently is for members of the LGS-ST-TOU and LGS-T-TOU rate classes, there appears to be little justification for instituting a class-wide rate reduction as well. In fact, it seems illogical to offer both special rate contracts and class-wide reductions because a customer can refuse the special rate contract and still benefit from the rate reduction. Thus, the incentives (and disincentives) CMP apparently wishes to obtain from special rate offerings are undermined when the customer will obtain much of the same relief whether or not it accepts the special rate offering.

On December 15, the Staff filed a response to UAH's comments. The Staff argued that UAH's comments are "untimely" but "should be considered by the Commission" "due to the importance of this matter to UAH." Staff indicated that it anticipated filing additional comments on this issue "after it has an opportunity to review CMP's response."

On December 16, the Public Advocate and CMP filed separate responses to UAH's comments. In its response, the OPA argues that the Commission should not "rely on speculations about CMP's motivation for proposing a tariff reduction" and asserts that CMP has legitimate justifications for its proposed schedule revisions. The OPA argues alternatively that if the Commission believes the UAH claims have merit, these claims should be dealt with in a separate proceeding pursuant to § 3306 rather than in the ARP proceeding. The OPA concludes that "UAH's allegations [do not] present a justifiable claim of price discrimination insofar as all members of the class will receive the identical price."

In its 15-page response to UAH's comments CMP argues that:

- UAH's predecessor had four types of contracts to choose from and chose the "Scott-type" contract;

- UAH has "enjoyed the benefits of rising revenues since the commencement of deliveries to CMP in February, 1989;"

- "UAH fails to recognize the justifiable business purposes for CMP's current course of action with respect to its largest customers;"

- The remedy sought by UAH "(either a rate freeze for itself or a prohibition against decreases only for holders of Scott-type contracts) is just the kind of 'discrimination against the electric consumers and electric utility in forming rates' that PURPA proscribes;"

- "The rate mechanism proposed under the ARP Stipulation and opposed by UAH in its comments clearly satisfies the anti-discrimination standard under state law and therefore PURPA;"

- "The UAH approach, not the ARP Stipulation or proposed rate tariff reduction, is an 'artifice' to manipulate the LGS-T-TOU and LGS-ST-TOU rate classes to protect an inflated profit stream for UAH" (emphasis in original);
- "[B]y entering into a contract with UAH, CMP did not undertake any obligation to structure its rates for various rate classes in a way to maintain or maximize profits for UAH;" and
- UAH has not argued that past rate increases or decreases were "artificial manipulation" of its contract with CMP.

On December 19, 1994, the Staff filed a supplemental response to UAH's comments. In its December 19 response, Staff asserts that the purpose of CMP's pricing flexibility proposal is to retain load. Staff argues that the purpose behind its proposal in Docket No. 93-076 "was to reduce CMP's revenue requirement in light of great ratepayer distress regarding the level of CMP's rates, and was not directly related to load retention issues." Staff further argues that

> [a] reduction in rates for an entire customer class for the purpose of load retention that also has the effect of lowering payments under "Scott-type" QF contracts does not contravene the bargain embodied in these contracts. These QFs can not have a legitimate expectation for any particular level of rates or that CMP would not be allowed to lower rates to retain load under lawfully adopted regulatory procedures. The "Scott-type" QFs clearly took the risk that the rates to which their contracts are tied could decrease, as well as increase during the terms of their contracts.

Staff notes, however, that "it is the allegation that CMP is using ARP pricing flexibility for the purpose of reducing contract payments and 'funding' load retention initiatives that is at the core of UAH's complaint." To address this latter issue, Staff recommends that the Commission direct CMP to file additional "information regarding the identity and load characteristics of those customers remaining on LGS-T and LGS-ST rate schedules and an analysis of why the rate schedule reductions are necessary to retain the load of these customers . . . . After reviewing this filing, the Commission can decide what further process, if any, is required."

On December 20, 1994, CMP filed a response to Staff's December 19 letter. In its December 20 response, CMP explains its rationale for class-wide reductions to its LGS-ST-TOU and LGS-T-TOU rates and the complications that would result if the further examination requested by Staff were granted.

On December 16, 1994, the City of Westbrook petitioned to intervene in this case "for the purposes of submitting limited comments" on the stipulated ARP. The City argues that "[i]f the Commission approves the ARP Stipulation, the City of Westbrook believes that CMP would reduce rates for industrial customers, which in turn would reduce CMP's payments to facilities within the City which will directly impact its tax base." The City asserts that "the proposed ARP Stipulation directly affects the value of 1/3 of the tax base of the City of Westbrook." In its December 16 Petition, the City requests that it be given until January 31, 1995, to file "detailed, formal Comments" on the stipulated ARP.

3. Analysis

In their Joint Motion filed on November 22, 1994, CMP and the IECG requested the Commission to issue certain waivers and findings that would allow the proposed schedules and 5-year contracts to take effect at the same time the stipulated ARP takes effect. These waivers and findings were discussed and issued in the Short Order that we issued on December 30, 1994.

We find that the revised rate schedules for rates LGS-ST-TOU and LGS-T-TOU filed on November 22, 1994, as modified by CMP's December 13, 1994 filing, [21] in conjunction with the waivers granted in our Short Order, comply with the ARP pricing flexibility criteria contained in Attachment F, sections I, I(A), I(B), I(C) and I(F) of the stipulated ARP.

We reject UAH's argument that CMP's proposed

[21] On December 13, CMP withdrew its proposed revision to page 80.00 of the LGS-ST-TOU Rate Schedule.

schedule revisions are contrary to our ruling in Docket No. 93-076 [22] or contrary to 35-A M.R.S.A. § 3309. We therefore deny both of the forms of relief requested by UAH discussed above. We generally concur with the arguments on this issue filed by CMP on December 16 and summarized above. We reject Staff's recommendation that CMP should be directed to file additional information about certain customers to give us additional insights into what may or may not have been CMP's motivation for proposing rate reductions for customers in the LGS-ST-TOU and LGS-T-TOU rate classes. CMP has provided sufficient justification for its proposed schedule revisions and has demonstrated that the proposed schedule revisions are consistent with the provisions of the stipulated ARP. No further inquiry by this Commission is needed. [23]

In our December 30 Short Order, we discussed and denied the untimely petitions to intervene filed by UAH and the City of Westbrook. In our Short Order, we noted that although we denied UAH's petition to intervene, we gave careful consideration to written comments filed by UAH regarding CMP's proposed schedule. We further noted in our Short Order that had the City of Westbrook filed timely written comments, those comments would also have been given due consideration.

D. Proposed 5-Year Contracts

The proposed Standard Form Contracts filed by CMP on December 19, 1994, [24] were filed pursuant to Attachment F, section III, of the Stipulation. The applicable criteria are set forth on pages 5-8 of Attachment F.

1. Positions of the Parties

In its November 22 filing, CMP provided rate

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[22] Order Concerning Staff Proposal for Retail Rate for Scott and S.D. Warren, Docket No. 93-076 (May 4, 1994).

[23] Such a finding by this Commission in no way limits UAH's right to pursue its alleged breach of contract claim against CMP in a court of law.

[24] CMP had filed earlier drafts of the Standard Form Contracts on December 8, 1994. The December 8 and December 19 drafts of the Standard Form Contracts were based on the Memorandum of Agreement filed by CMP on November 22, 1994.

design workpapers that are intended to show the calculation of "the proposed rates and demonstrate that the 15%, 16% and 18% reductions have been taken from the energy charges." CMP included additional workpapers in its November 22 filing that were intended to show "proposed floors compared with the rates demonstrating that the rates do not fall below the floors" and "annual short-term marginal energy costs compared with annual contract rates for the five-year term; . . . annual short-term capacity costs compared with proposed contract rates over the five-year term and . . . 'short-run marginal costs plus 1.5 cents over the term of the contract' compared to the revenue collected over the contract term [Attachment F, section III(B)(2)]."

In its November 22 filing, CMP asserts that "the proposed contracts [do not] induce permanent load and, thus, it does not believe proof respecting these tests [in Attachment F, sections III(E) and IV] is necessary." CMP concludes that "the special contract rates are beneath the caps, satisfy the marginal cost floors and are neither anti-competitive nor unduly discriminatory."

In their Joint Motion, the IECG, CMP, the OPA and the CCUC asserted that "the five-year contracts conform with the pricing flexibility provisions [of the stipulated ARP] . . . and that they are not anti-competitive or unduly discriminatory."

In Comments filed on December 14, the Advocate Staff represented that

> individual special contracts substantially similar to the standard form contracts filed by CMP on December 8 only applied to existing customers and existing usage (including usage fluctuations referred to as "creep"), would comply with the pricing flexibility criteria contained in Attachment F, Sections III(A) and III(B) of the pending ARP Stipulation. We will review individual contracts when filed. We wish to emphasize that our view with respect to the compliance of the special contracts is premised on our understanding that the contracts are not intended to and will not have of the effect of inducing permanent load to any significant degree.

2. Comments from the Public

Two members of the public filed letters commenting on CMP's proposed 5-year contracts. In comments filed on November 28 and November 29, respectively, Peregrine Technologies and Turbonetics Equipment assert that the contracts offered by CMP are anti-competitive and "predatory" in nature. Turbonetics asserts that CMP will enter into a such a contract only if the industrial customer agrees not to install the type of equipment Turbonetics manufactures and notes that "[t]his policy would enable CMP to use its leverage as a monopoly to successfully buyoff even small steam turbine projects which would capture opportunities to produce power at no cost."

On December 19, 1994, Turbonetics filed additional comments. In these additional comments, Turbonetics discusses a project it has developed with a paper mill in Maine. Turbonetics argues that despite the project's clearly lower cost, the stipulated ARP will allow CMP to effectively block the installation of the project. Turbonetics argues that "[t]he use of special rate contracts to buyoff small scale generation projects which offer power at a lower cost than CMP is an <u>anti-competitive</u> policy." (emphasis in Original)

To correct this problem, Turbonetics proposes that the following language be added to Attachment F, section III(B): "Special rate contracts shall not prevent the installation of generation equipment or the development of energy efficiency projects which offer the customer a lower cost source of power than the contractual rate provided by the Company."

In its December 12, 1994 response to the comments of Turbonetics and Peregrine Technologies, CMP argues that two provisions in the ARP prevent the Company from engaging in predatory or discriminatory pricing. The first is the requirement in Attachment F, section I that requires that rates be set for existing core customer classes between the rate cap and a floor equal to long-term marginal cost. The second is the requirement in Attachment F, section III(B)(2) that requires that the revenue collected from special rate contracts will be no lower than the Company's short-run marginal cost plus 1.5¢/kWh. CMP concludes that "[i]f Turbonetics cannot match CMP's fairly computed prices, it is a consequence of fair competition and should not give the Commission grounds for rejecting the revised rates or contracts."

In response to the November 29 Turbonetics letter, the Advocacy Staff filed comments on December 14 in which it asserted the following:

> With regard to the comments on the LGS proposals that have been filed by customers and other interested persons, no issues were raised that, in our view, would justify denying or delaying implementation of the LGS proposals. Although anti-competitive and predatory pricing issues were raised in the comments of Turbonetics Equipment, Inc. and Peregrine Technologies, Inc., it is our view that the marginal cost floor criteria that govern pricing flexibility pursuant to the ARP and that, as noted above, are met by the LGS proposals, provide reasonable protection against the predatory pricing issues raised by Turbonetics and Peregrine.

However, after reviewing Turbonetics December 19 letter, Staff filed additional responsive comments on December 19, 1994. In its December 19 comments, Staff indicates that it "now believes that Turbonetics and Peregrine have raised a legitimate issue implicating the anti-competitive provisions of the ARP." Staff notes that in a fully competitive market, a customer would have the option to supply a portion of its load through efficient technology (such as that offered by Turbonetics) and the remainder of its load through an open market. Staff concludes, however, that if CMP can induce a customer to forego the more efficient technology for part of the customers load by offering the customer a reduced rate on the customer's entire existing load, then CMP has "market power" which may implicate the anti-competitive provisions of the ARP. In Staff's view,

> the pricing flexibility provisions of the ARP were not intended to allow CMP to use "market power" to prevent or impede the development of lower cost energy options. Such a result, we believe, is prohibited by the anti-competitive provisions of ARP (at least without explicit Commission review and approval) and is precisely the kind of situation that the notice and comment procedure is intended to uncover.

Staff notes that it does not know if the anti-competitive pricing tactics complained of by Turbonetics and Peregrine have in fact occurred. Staff therefore recommends that the Commission declare that the alleged behavior is anti-competitive and not permissible under the ARP's 30-day approval process and direct CMP to file a written response to Turbonetics allegations.

On December 20, 1994, CMP filed a response to Staff's December 19 letter. In its December 20 response, CMP asserts that Turbonetics' allegations are "totally unfounded and unsupported." The Company also addresses the specific situation that it asserts gave rise to Turbonetics' allegations.

> The irony of the Turbonetics allegations is that the customer (not CMP), exercised its bargaining power to force CMP to deal with the deferral of the turbine simultaneously with the remainder of the load. The situation at issue is a 3 MW turbine at Otis Specialty Paper (which will replace a 1 MW turbine). In response, Otis informed CMP that it wanted to address its total load in a single package. Further evidence of the total lack of market power exercised by CMP will be filed with the Commission when the Otis contract is executed. That contract, in the Self-generation Deferral Rider, contains a provision that if the Commission does not approve the turbine deferral rate, the Customer, at its sole discretion, can terminate the entire Customer Service Arrangement. This provision and the prior conduct of the parties clearly shows that CMP used no market power to prevent Otis from installing the Turbonetics generator.

3. Analysis

We find that the Standard Form Contracts filed by CMP on December 19, 1994, are consistent with the provisions of the stipulated ARP and are not anti-competitive or unduly discriminatory. Specifically, we find that the Standard Form Contracts, in conjunction with the waivers granted in our December 30 Short Order, comply with the pricing flexibility criteria contained in Attachment F, section III(B).

We agree with CMP that the requirements in Attachment F, section I (rates must be set for core customers between the rate cap and a floor equal to long-term marginal cost) and Attachment F, section III(B)(2) (revenue from special rate contracts will be no lower than the Company's short-run marginal cost plus 1.5¢/kWh) prevent CMP from engaging in predatory or discriminatory pricing. Contrary to the assertions of Turbonetics, we do not view CMP's offering to its LGS-ST-TOU and LGS-T-TOU customers through the 5-year contracts in question as a monopoly product. Customers in those rate classes have received the rate discount discussed in part C above and are not required to enter into a 5-year contract to receive the initial rate reduction. Such customers could, if they so choose, decline to enter into a 5-year contract with CMP and instead enter into a contract with a competitor of CMP's such as Turbonetics.

We reject the argument that customers should be guaranteed the opportunity to simultaneously contract with CMP and a technology supplier such as Turbonetics. Such a guarantee would destroy the balance that motivates CMP to enter into the 5-year contracts.

The tariffed rate is the price that this Commission establishes as the primary constraint against CMP exercising market power; CMP is not free to collect monopoly rents by raising its price to profit-maximizing levels. So long as CMP sets its prices above cost (as the ARP requires), and so long as those prices continue to be at or below the tariff level (as the ARP also requires), CMP has no "market power" to injure customers or competitors. Customers can simply decline to sign contracts and rely on the tariffed rate; competitors can offer whatever inducements they choose to persuade customers to remain on the tariff (and not sign contracts) and purchase their products instead.

E. Executed Customer Service Agreements

In our Short Order issued on December 30, 1994, we delegated our authority to review executed Customer Service Agreements (CSA) to the Director of our Technical Analysis Division. CMP filed executed CSAs with the following customers on the following dates:

Champion International Corporation	December 20, 1994
Otis Specialty Products, Inc.	December 21, 1994
The Chinet Company	December 21, 1994
Portland Pipe Line Corporation	December 21, 1994
Forster, Inc.	December 22, 1994

Bath Iron Works [25]	December 22, 1994
CYRO Industries	December 22, 1994
Dragon Products Co.	December 22, 1994
Boise Cascade Corporation	December 27, 1994
National Semiconductor Corporation	December 27, 1994
United Technologies Corporation, Pratt & Whitney	December 27, 1994
International Paper	December 27, 1994
Gates Formed Fibre Products, Inc.	December 27, 1994
Philips Elmet	January 4, 1995

On January 6, 1995, the Director of our Technical Analysis Division issued a Supplemental Order Relating to Contracts. In the January 6 Order, the Director found that each of the 14 above-listed contracts is consistent with the stipulated ARP [26] and ordered that the CSAs could take effect on January 6, 1995.

F. Procedure for Processing Additional Executed Customer Service Agreements

In our December 30 Short Order, we indicated that executed CSAs (1) filed pursuant to the program initiated by CMP in its November 22 filing and (2) filed after December 27, 1994, will be reviewed by the Director of Technical Analysis as they are received.

VI. CONCLUSION

We have reviewed the discrete components of the stipulated ARP and find them reasonable. We have also reviewed the Stipulation on an integrated basis and find that it constitutes a reasonable plan for regulating CMP for the next 5 years. We have

[25] On December 27, 1994, CMP filed "Attachment B" to the Bath Iron Works CSA that had been inadvertently omitted from its December 22 filing.

[26] The Supplemental Order made clear that that Order did not approve any of the Package Power riders attached to any of the CSAs discussed in the Order. The Supplemental Order also indicated that the Director's findings in that Order were premised on the understanding that each CSA addressed in the Order was not expected to induce permanent load.

conducted our integrated analysis from three different perspectives. From a financial perspective, we conclude that the stipulated ARP is sufficiently robust and flexible. From a qualitative perspective, we conclude that the stipulated ARP satisfies the goals, and is reasonably likely to produce a substantial portion of the benefits, that we articulated in our Phase I Order. From a legal perspective, we conclude that the Commission has the authority to implement the stipulated ARP and that doing so is not contrary to other provisions of Title 35-A.

For all of these reasons, we adopt the stipulated Alternative Rate Plan for CMP, submitted by several parties in this case on October 14, 1994. We look forward to working diligently to ensure that this new form of regulation brings benefits to CMP's ratepayers and shareholders and, we are confident, to the State of Maine.

Accordingly, in addition to the ordering paragraphs contained in our Short Order issued on December 30, 1994, it is

O R D E R E D

1. That the stipulating parties shall prepare and submit the issues lists, schedules, explanations and discussions set forth in Part IV (c)(6) of this Order; and

2. That this docket is hereby closed.

Dated at Augusta, Maine, this 10th day of January, 1995.

BY ORDER OF THE COMMISSION

Charles A. Jacobs
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Hughes
Nugent

This document has been designated for publication

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of adjudicatory proceedings are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 6(N) of the Commission's Rules of Practice and Procedure (65-407 C.M.R.11) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which consideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attached a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.

APPENDIX A

PROCEDURAL HISTORY

On December 29, 1992, CMP filed a 60-day notice of intent to file a request for an increase in non-fuel rates of approximately $95 million. On December 14, 1993, the Commission issued its final Order in Phase I of this case in which it (1) ordered the Company to file schedules to increase its rates by approximately $26 million; (2) found CMP's performance in the area of management efficiency and cost cutting to have been inadequate; and (3) determined that an alternative rate plan (ARP) is likely to be a better means to ensure that ratepayers do not pay for inefficiency and that management has the proper incentive to control costs. In the December 14 Order, we initiated Phase II of this case in which CMP and other parties were given an opportunity to work out the details of a specific ARP for CMP. The December 14 Order noted that if the parties were unable to reach consensus on an ARP proposal, the Commission would initiate a formal Phase II proceeding in which we would consider an ARP for CMP.

After several months of discussions among the parties, negotiations broke off. On April 22, 1994, the Examiner issued a Scheduled Order initiating a process and schedule to be followed. On May 10, 1994, the Commission held a Conference of Counsel to discuss issues and procedures. The Phase I parties who requested to participate as parties in Phase II include the ABC, the Navy, the Public Advocate, the IECG, the AARP, BIW, [27] the CCUC and Madison Paper. [28] Parties filed direct testimony on June 15; rebuttal testimony on July 21 and 28; and surrebuttal testimony on August 11 and 16. With its direct testimony, CMP filed a specific plan that became known as the CMP ARP. Several non-CMP parties supported an alternative plan that became known as the Public Party/Customer Proposal (PPCP) ARP.

The Commission held a case management conference on September 1. Public witness hearings were held in Portland on September 7, Lewiston on September 8 and Augusta on September 19,

[27]On April 26, 1994, BIW filed a letter indicating its desire to "remain on the service list for Phase II of this case." However, BIW did not actively participate in Phase II.

[28]On October 13, 1994, Madison Paper filed a letter noting that because it is no longer a retail customer of CMP it is withdrawing as a party in the Phase II proceeding.

for the purpose of hearing testimony from the general public on the merits of any alternative to traditional forms of utility regulation for CMP. Twenty-five public witnesses testified at these hearings. Some members of the public spoke in favor of, and some opposed, the concept of an ARP for CMP and the specific ARP proposals then pending before the Commission.

The Commission held evidentiary hearings from September 15 through September 28 during which the following witnesses testified and were cross-examined: September 15, Marsh/Call; September 16, Marsh/Call, Alexander, Green and Weil; September 19, Christensen/Lowry, Kahn; September 20, Kahal and Kahn; September 21, Huntington; September 23, Force/Cutter; and September 26, Talbot, Carlson and Goodman. Testimony during hearings focused on the relative merits of the CMP and PPCP ARP and the question of whether any ARP should be adopted for CMP at this time.

On October 6, the Staff filed a letter representing that the Staff, CMP, the OPA, the CCUC and the Navy had reached an agreement in principle that sought to resolve all remaining issues in the Phase II proceeding. On October 14, CMP filed a Stipulation on behalf of those parties. [29] On October 17, the Commission held a conference of counsel to discuss the processing of the Stipulation.

On November 3, the Commission held a hearing on the Stipulation during which David Marsh, Barbara Alexander, Faith Huntington and Gordon Weil responded to questions about the Stipulation.

On November 22, CMP filed a two-part program proposal pursuant to the Flexible Pricing terms of the then-pending ARP Stipulation. The two-part program included revised schedules and 5-year special rate contracts for members of CMP's LGS-ST-TOU and LGS-T-TOU rate classes. Also on November 22, the IECG, CMP, the OPA, and the CCUC filed a Joint Motion to establish procedures for processing the remainder of this case and obtain waivers of certain provisions to permit the Commission to consider the revised rate schedules and proposed 5-year contracts at the time the Commission deliberates the merits of the stipulated ARP. By Order issued on November 22, the Examiner granted the Joint

[29] The AARP ultimately signed the Stipulation. The IECG and BIW have taken no formal position with regard to the Stipulation. The ABC is the only party that opposes the Stipulation.

Motion.

On November 23, the following parties filed briefs in this proceeding: the Staff, CMP, the OPA, the AARP, the CCUC, the ABC and the Navy. An Examiner's Report was issued on December 9. Exceptions were filed by the following parties on December 14 by the Staff, OPA, CCUC and CMP. The Commission held deliberations on the stipulated ARP and CMP's revised rate schedules and proposed contracts on December 20, 1994.

Between December 20, 1994 and January 4, 1995, CMP filed 14 executed Customer Service Agreements (CSAs) as part of the 5-year contract portion of its November 22 program proposal.

The Commission issued a Summary of Decision and Order ("Short Order") in this case on December 30, 1994. The December 30 Short Order approved the October 14 Stipulation; granted certain waivers requested in the November 22 Joint Motion; allowed the rate schedules filed by CMP on November 22 to take effect; found that the Standard Form Contracts filed by CMP on December 19 were consistent with the stipulated ARP and not anti-competitive or unduly discriminatory; and delegated authority to the Director of the Commission's Technical Analysis Division to review the executed CSAs.

On January 6, 1995, the Director of the Commission's Technical Analysis Division issued a Supplemental Order relating to contracts in which he found that each of the 14 CSA's filed between December 20, 1994 and January 4, 1995 is consistent with the stipulated ARP and ordered that the CSAs could take effect on January 6, 1995.

APPENDIX B

Summary of Direct Testimony Positions of Parties

CMP ARP Docket No. 92-345 (Phase II)

No.	Issues	CMP ARP	PPCP	STIPULATION
1	Price Index	CPI-U	GDP-PI	GDP-PI
2	Profit Sharing	2/3 customer; 1/3 stockholder outside ± 150 basis point bandwidth	50/50 sharing outside ± 350 basis point bandwidth with 10.55% ROE	50/50 sharing outside ± 350 basis point bandwidth with escalating ROE
3	Produc-tivity Offset	1/3 of inflation index beginning in 1997	0.5% in '95 &'96; 1.0% in '97; 1.5% in '98 &'99	0.5% in '95; 1% in '96-'99 with a "QF" factor to adjust for non-inflation driven costs.

No.	Issues	CMP ARP	PPCP	STIPULATION
4	Annual review	Index, sharing, mandates, customer service and reliability, reporting and compliance	Index, sharing, marginal costs, mandates, customer service and reliability, reporting and compliance	Index, sharing, marginal costs, mandates, customer service and reliability, reporting and compliance
5	Customer Satisfac-tion & Reliab'ity	No penalties	Measured to baseline; penalties up to $5.0 million if below baseline	Measured to baseline; penalties up to $3.0 million if below baseline
6	Definition of Mandated Costs	DSM, QF contract buyout and restructuring	Narrow list includes flowthroughs plus ERAM & canceled plant amortizations	DSM, ELP, FASB106, QF restructuring plus extraor-dinary costs

No.	Issues	CMP ARP	PPCP	STIPULATION
7	Fuel and Purchased Power Cost Recovery	Recovery thru CPI-U index and no reconciliation	The FCA suspended; not reconciled; separate escalation	Recovery thru GDP-PI Index
8	DSM issues	Mandate (flowthrough); Standards to follow	Mandate (flowthrough); Standards to follow	Mandate (flowthrough) additional proceeding; standards; penalties
9	Option to Terminate	Review in '97 and termination feature	Review in four years and authority to modify or terminate	Review in '97 to consider: 1) cost of capital, 2) pricing flexibility, 3) Electric Lifeline Program Funding, 4) other ARP components

No.	Issues	CMP ARP	PPCP	STIPULATION
10	Flexible Pricing	Capped @ Index; Floor @ MC	Capped @ Index; Floor @ long-run MC; detailed provisions	Capped @ Index; Floor to be established; detailed provisions
11	Electric Lifeline Program	Continues at current level	Continues at current level	Continues at current level